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WEDTECH: A REVIEW OF FEDERAL PROCUREMENT DECISIONS

A REPORT

PREPARED BY THE

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

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LETTER OF TRANSMITTAL

U.S. SENATE,
SUBCOMMITTEE ON OVERSIGHT
OF GOVERNMENT MANAGEMENT,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC, May 4, 1988.

Hon. JOHN GLENN,
Chairman, Committee on Governmental Affairs,
Washington, DC.

DEAR MR. CHAIRMAN: The Subcommittee on Oversight of Government Management transmits the following report on its investigation of federal procurement decisions related to the Wedtech Corporation.

The Subcommittee began its investigation in late 1986 when allegations of improper activities relative to the award of certain federal contracts to the Wedtech Corporation surfaced. Wedtech was a small company located in the South Bronx which participated in the Small Business Administration's (SBA's) 8(a) program for small and disadvantaged businesses which declared bankruptcy in 1986 under a flood of allegations of illegal conduct. The Committee's responsibilities in the area of government-wide procurement and ethics led us to examine the involvement of the federal government in the growth and demise of Wedtech.

The report we are forwarding to you presents an unfortunate picture of favoritism, political influence, mismanagement, and improper and irregular decisionmaking by several federal agencies as well as unethical conduct by several federal employees. We hope that the lessons we have learned from this investigation will help improve future government decisionmaking, so that some good will result from this tale of misdeeds.

The Subcommittee has looked at four Executive Branch entities: the White House, the Small Business Administration, the Navy and the Army. Based on our analysis of the facts and our findings, we have made 16 recommendations for improvements in the 8(a) program, the procurement process and ethics enforcement. We have been working closely with the Small Business Committee in its efforts to amend the 8(a) program, and we expect the bill that committee is considering will include many of our recommendations. We will pursue the remaining recommendations through other legislation and administrative changes in the Executive Branch. Implementation of the Subcommittee recommendations will, we believe, go a long way toward insulating the federal procurement process from improper influence.

Sincerely,

CARL LEVIN, *Chairman.*

CONTENTS

	Page
Letter of Transmittal	III
I. Executive Summary	1
A. Subcommittee Findings	2
1. Department of the Army	2
2. Small Business Administration	2
3. Department of the Navy	3
4. Individuals	3
B. Subcommittee Recommendations	4
1. The Section 8(a) Program	4
2. Lobbying and Government Ethics	5
3. Other Contracting Issues	5
II. Background and Overview	7
A. The 8(a) Set-Aside Program	7
B. A Brief History of Wedtech	8
1. The Beginnings	8
2. The Army Engine Contract	8
3. The Eligibility Decisions	9
4. The Navy Pontoon Contract	9
5. The Collapse of Wedtech	10
C. Wedtech's General Ally Structure	11
D. The Subcommittee's Investigation and Hearings	12
III. Evidence Received by the Subcommittee	15
A. The Army Engine Contract	15
1. The Origins of the Contract	15
a. The Set-Aside of the Contract and the Selection of Wedtech	15
b. Wedtech's Efforts to Overcome The Army's Resistance	18
2. The Audit of Wedtech's Proposal	23
a. The First Attempt to Withdraw the Set-Aside	23
b. The Army's Decision to Audit	27
c. The Results of the Audit	29
3. The Award to Wedtech	32
a. The Second Attempt to Withdraw the Set-Aside	32
b. The White House Involvement	37
c. The May 19 Meeting	41
d. Negotiation and Award	43
4. Discussion and Findings	47
a. The Merits of the Award	47
b. The Reasons for the Award	48
c. The White House Role	50
B. The SBA's Approval of Wedtech's 8(a) Eligibility	53
1. The Public Stock Offering	53
a. The Termination Recommendation	53
b. Wedtech's Efforts to Influence the SBA	54
c. The Bridge Letter	55
2. Wedtech's Stock Transaction	56
a. The Structure of the Transaction	56
b. Approval by the New York SBA	58
c. Approval by the National SBA	61
3. The Economic Disadvantage Issue	64
a. The Effects of the Stock Offering	64
b. The SBA's Approval	65
c. Wedtech's 8(a) Term Extension	67

Page

4. Discussion and Findings 68
a. The Bridge Letter 68
b. The Sham Stock Transaction 69
c. The Economic Disadvantage Issue 71
d. Wedtech's Fixed Program Term 73
C. The Navy's Set-Aside of the Pontoon Contract 75
1. The Navy's Reversal 75
a. The Initial Decision 75
b. The SBA Appeal 77
c. The Set-Aside Decision 78
2. Wedtech's Efforts to Influence the Navy 81
a. Wedtech's Allegations 82
b. The Assistant Secretary's Denial 83
c. The White House Role 87
3. Discussion and Findings 88
a. The Merits of the Decision 88
b. The Reasons for the Decision 89
c. The Appearance of Impropriety 91
D. The Award of the Pontoon Contract to Wedtech 94
1. Wedtech's Attempts to Influence the SBA 94
a. Wedtech's Competitors 94
b. Direct Contacts with the SBA 96
2. The SBA Selection Process 99
a. The Selection of Wedtech and Medley 99
b. The Problems with Wedtech 102
c. The Elimination of Medley 105
3. The Negotiation of the Contract 106
a. The Site Visit 106
b. The Assistant Secretary's Approval 107
c. The Lack of a Pre-Award Survey 108
d. The Price Negotiations 109
4. Discussion and Findings 112
a. The SBA's Selection Process 112
b. The Conduct of the Deputy Associate Administrator 114
c. The Navy's Approval of Wedtech 115
E. Wedtech's Performance and the Options 117
1. The Piersall Report 117
a. The Decision to Seek a Report 117
b. The Report 118
c. The Wedtech Letter 119
d. The Response to the Report 120
2. The 1985 Options 121
a. Wedtech's Efforts to Influence the Navy 121
b. The Letter Contract Issue 123
c. The Exercise of the Options 125
3. The 1986 Options 126
a. The Hughes Memoranda 126
b. The Sole Source Decision 128
c. The New Program Manager 129
d. The Two Pre-Award Surveys 131
4. Wedtech's Bankruptcy 134
a. The Progress Payment Issue 134
b. The Reasons for Overpayment 137
c. Default, Bankruptcy and Reprocurement 138
5. Discussion and Findings 139
a. The Piersall Report 139
b. The Letter Contract Issue 140
c. The 1985 Options 141
d. The 1986 Options 142
e. The Progress Payment Issue 143
IV, Recommendations 145
A. The Section 8(a) Program 145
1. Disadvantaged Ownership 145
2. Economic Disadvantage 146
a. The Criteria for Economic Disadvantage 147
b. Economic Disadvantage After Program Entry 149

Page

3. Program Participation 150
a. Fixed Program Participation Terms 150
b. Termination Procedures 151
4. Competitive Contracting 152
5. Business Development 155
a. Business Mix 155
b. Business Development Expense Grants 156
B. Lobbying and Government Ethics 158
1. Lobbying Activities 158
a. Friends of Current Officials 159
b. Other Agencies 159
c. Partners and Associates 160
2. White House Involvement in Procurement Decisions 161
C. Other Contracting Issues 162
1. Documentation of Decisions 162
2. Progress Payments 163

APPENDIXES

Appendix I: Key Individuals 165
Appendix II: Army Engine Contract Documents in the Subcommittee's Public Files 167

I. EXECUTIVE SUMMARY

In November 1986, the Subcommittee on Oversight of Government Management of the Senate Governmental Affairs Committee began a review of federal procurement decisions related to the Wedtech Corporation. This investigation, which arose out of the Committee's jurisdiction over government-wide procurement, management and ethics issues, culminated in four days of hearings in September 1987. In the course of its Wedtech investigation, the Subcommittee has heard testimony from fourteen witnesses, conducted more than 150 interviews, and reviewed thousands of pages of documents, including trial transcripts.

The Subcommittee's investigation has focused on the issue of Wedtech's eligibility for the Section 8(a) set-aside program for disadvantaged small business and on two major contracts awarded to Wedtech under the 8(a) program, a 1982 Army contract for small engines and a 1984 Navy contract for pontoon causeways. This report traces the involvement of four federal agencies—the White House, the Army, the Navy, and the Small Business Administration—in determining Wedtech's eligibility and awarding these contracts.

Part I of this report is an executive summary, which summarizes the Subcommittee's findings and recommendations. Part II provides a background and overview of the 8(a) program, the history of Wedtech, and the Subcommittee's investigation. Part III describes the evidence received by the Subcommittee in the course of its investigation: Subpart A addresses the Army engine contract; Subpart B addresses the eligibility issue; and Subpart C, D, and E address the Navy pontoon contract. Part IV provides a discussion and explanation of the Subcommittee's recommendations.

The Subcommittee held four days of hearings in September 1987, focusing primarily on the eligibility issues and the Navy pontoon contract. Due to concerns expressed by Independent Counsel James McKay about the possible impact of such hearings on his prosecution of former Wedtech consultants Lyn Nofziger and Mark Bragg for illegal lobbying on the Army engine contract, the Subcommittee heard testimony from only two witnesses—the former Administrator and Deputy Administrator of the Small Business Administration—about the engine contract. The Subcommittee decided to delay full hearings on the engine contract until the conclusion of the trial of Messrs. Nofziger and Bragg. In light of extensive public testimony on the contract at that trial, however, the Subcommittee subsequently elected not to hold additional hearings about the engine contract, but to rely on the trial transcript and staff interviews.

A. Subcommittee Findings

The Subcommittee finds that:

1. DEPARTMENT OF THE ARMY

(1) While there was a valid social policy reason why the Army engine contract should have been awarded to Wedtech and while the Army found Wedtech to be capable of performing, given enough time and money, there were substantial procurement policy reasons why the contract should not have been awarded to Wedtech. (*See* Section III.A.4.a.)

(2) Wedtech's proposal for the Army engine contract would not have been audited in 1981, but for the intervention of the White House and the Congress. (*See* Section III.A.4.b.)

(3) The Army would not have awarded the Army engine contract to Wedtech, but for the intervention of the White House. (*See* Section III.A.4.b.)

2. SMALL BUSINESS ADMINISTRATION

(4) The SBA awarded $3 million in Business Development Expense grants and $2 million in advance payment loans to Wedtech for the performance of the Army engine contract despite the belief of high SBA officials that this award was excessive in amount and was a poor use of the agency's limited funds. The SBA would not have made this award, but for the intervention of the White House. (*See* Section III.A.4.b.)

(5) The SBA improperly gave Wedtech a temporary 8(a) extension in September 1983, at a time when the company, by its own admission, was no longer owned by disadvantaged individuals as a result of its public stock offering. (*See* Section III.B.4.a.)

(6) The stock transaction entered into by Wedtech's owners in January 1984 was a sham that did not convey ownership and control of the company to John Mariotta, Wedtech's disadvantaged "owner", and never should have been approved by the SBA. (*See* Section III.B.4.b.)

(7) The Wedtech stock transaction was approved by SBA officials at the local level with unreasonable haste, outside normal decision-making channels, and with complete disregard for obvious facts. The fact that this process resulted in the approval of an obvious sham transaction raises a serious question whether SBA officials intentionally bent eligibility rules for the purpose of assisting a well-connected and favored company. (*See* Section III.B.4.b.)

(8) The Wedtech stock transaction was approved by SBA officials at the national level after a superficial review that indicates at a minimum a serious lack of diligence and possibly conscious favoritism for a well-connected company. (*See* Section III.B.4.b.)

(9) The SBA ignored the facts in determining that Wedtech's owners were economically disadvantaged when they were multi-millionaires and had proven access to millions of dollars in capital and loans. (*See* Section III.B.4.c.)

(10) The SBA improperly granted Wedtech a three-year extension of its 8(a) term without considering the factors set forth in its Standard Operating Procedures. The circumstances of this decision create at a minimum the appearance that it was made for the pur-

pose of awarding a lucrative contract to a well-connected and favored company. (*See* Section III.B.4.d.)

(11) The SBA ignored obvious problems with Wedtech's 8(a) eligibility, overdependence on 8(a) contracts, and ability to perform when it selected Wedtech as its candidate for the pontoon contract. The evidence received by the Subcommittee creates at a minimum the appearance that Wedtech was chosen because it was well-connected and not because of its qualifications or because it was the best candidate. (*See* Section III.D.4.a.)

3. DEPARTMENT OF THE NAVY

(12) The Navy decided to set aside the pontoon contract despite the belief of officials responsible for administering the contract that this decision would result in late delivery and have a detrimental impact on the national defense. (*See* Section III.C.3.a.)

(13) The Navy agreed to set aside the pontoon contract at least in part because of pressure from Wedtech's well-connected consultants. (*See* Section III.C.3.b.)

(14) The Navy approved the award of the pontoon contract to Wedtech despite the knowledge that the company could not meet the Navy's critical production schedule, because it lacked relevant experience and existing production facilities. (*See* Section III.D.4.c.)

(15) The Navy improperly rushed to a procurement decision without a pre-award survey necessary to fully evaluate Wedtech's capabilities. (*See* Section III.D.4.c.)

(16) The Navy memorandum directing the exercise of the 1985 pontoon options without price negotiations would have served no legitimate government interest if implemented. (*See* Section III.E.5.b.)

(17) The Navy memorandum directing the exercise of the 1985 pontoon options without price negotiations was highly unusual and the inability of any Navy official to explain the origin of the memorandum suggests that it may have originated from someone outside the Navy. (*See* Section III.E.5.b.)

(18) The Navy ignored early warning signals of Wedtech's inability to perform the pontoon contract and the advice of its frontline personnel, leaving itself with no choice but to award the 1985 pontoon options to Wedtech. (*See* Section III.E.5.c.)

(19) The second pre-award survey conducted on the 1986 pontoon options documented a pre-determined conclusion, and the Navy awarded the options to Wedtech despite substantial evidence that the company was financially incapable of performing. (*See* Section III.E.5.d.)

(20) The Navy knowingly overpaid Wedtech and lost millions of dollars on the pontoon contract despite substantial evidence that the company was financially incapable of performing the contract. (*See* Section III.E.5.3.)

4. INDIVIDUALS

(21) Former Counselor to the President Edwin Meese III and former Deputy Counselor Jim Jenkins failed to observe the White House policy on contacts with procurement officials, which failure

resulted in improper favoritism toward a specific contractor. (*See* Section III.A.4.c.)

(22) The testimony of SBA officials at both the local and the national level regarding their approval of Wedtech's sham stock transaction is implausible and insufficient to explain known facts. (*See* Section III.B.4.b.)

(23) Assistant Navy Secretary Everett Pyatt's testimony about his actions and rationales for agreeing to set aside the pontoon contract for Wedtech contains serious inconsistencies and contradicts relevant documents, warranting further investigation. (*See* Section III.C.3.b.)

(24) Mr. Pyatt's attendance at lunches and anniversary parties and the inaugural ball as a guest of Wedtech consultants Lyn Nofziger and Mark Bragg created at a minimum the appearance of impropriety. (*See* Section III.C.3.c.)

(25) The inconsistent explanations given by SBA officials for the selection of Wedtech for the pontoon contract are implausible and insufficient to explain why the obvious problems with Wedtech were overlooked. (*See* Section III.D.4.a.)

(26) Former Associate SBA Administrator Robert Saldivar's conduct in failing to report Wedtech's attempted payment to him and continuing to participate in federal decisions relative to Wedtech was a clear violation of SBA regulations and was highly improper. (*See* Section III.D.4.b.)

(27) The Piersall Report on Wedtech's performance emphasized Wedtech's complaints and ignored substantial problems with Wedtech's production methods, quality and timeliness that had been observed by other Navy personnel. The report's failure to point out these difficulties may have prevented the Navy from fully recognizing the extent to which Wedtech was unable to perform. (*See* Section III.E.5.a.)

(28) The conduct of former Principal Deputy Secretary of the Navy Wayne Arny and Captain Charles Piersall in advising Wedtech to send an October 9, 1984 letter to NAVFAC creates the appearance that they were representing the interests of the contractor. (*See* Section III.E.5.a.)

B. Subcommittee Recommendations

The Subcommittee's recommendations are as follows:

1. THE SECTION 8(a) PROGRAM

(1) Section 8(a) of the Small Business Act should be amended to clarify that the required 51% ownership of a company or its stock by a socially and economically disadvantaged individual must be unconditional. (*See* Section IV.A.1.)

(2) The SBA should be required to establish a threshold value of personal net worth that presumptively indicates a lack of economic disadvantage, but that provides a limited exception for personal assets invested in the 8(a) firm itself. (*See* Section IV.A.2.)

(3) Section 8(a) should be amended to clarify that 8(a) contracts may be awarded only to firms that are economically disadvantaged at the time of the award. (*See* Section IV.A.2.)

(4) Section 8(a) should be amended to strictly limit Fixed Program Participation Term extensions. (*See* Section IV.A.3.)

(5) Section 8(a) should be amended to require the SBA to schedule a hearing on any termination recommendation within three months of the initial notification to the company. (*See* Section IV.A.3.)

(6) Section 8(a) should be amended to require competition among 8(a) contractors for contracts over an established dollar value (including options for additional purchases). (*See* Section IV.A.4.)

(7) Section 8(a) should be amended to permit the sole-source award of a contract of any dollar value only with careful documentation of the qualifications of the selected contractor, the reasons for the selection, and the basis for the rejection of other contractors (where other contractors were considered). (*See* Section IV.A.4.)

(8) Participants in the 8(a) program should be required (after a reasonable amount of time in the program) to obtain a minimum percentage of their business from non-8(a) sources. Companies that fail to achieve the requisite percentage of non-8(a) business should not be awarded additional 8(a) contracts. (*See* Section IV.A.5.)

(9) Limits should be placed on the size of any one 8(a) contract in relationship to past contracts and the total volume of a company's business. (*See* Section IV.A.5.)

(10) Section 8(a) should be amended to limit the amount of Business Development Expense (BDE) grant money that may be awarded to any one company. (*See* Section IV.A.5.)

2. LOBBYING AND GOVERNMENT ETHICS

(11) The Ethics in Government Act should be amended to require disclosure of Executive Branch lobbyists, similar to that currently required of Legislative Branch lobbyists. (*See* Section IV.B.1.)

(12) The post-employment lobbying law should be amended to prohibit former, very senior Executive Branch officials from having contact with any Executive Branch agency for one year following federal employment. (*See* Section IV.B.1.)

(13) The post-employment lobbying law should be amended to prohibit any person from communicating in the course of lobbying that such lobbying is on behalf of a former official if that former official is prohibited by law from engaging in such lobbying personally. (*See* Section IV.B.1.)

(14) The current White House policy on contacts with procurement agencies (which prohibits staff members from contacting procurement officials on behalf of friends or relatives with a financial interest in a contract) is a sound policy which should be broadened to cover friends or relatives with *any* interest in a contract, and should be continued by future administrations. (*See* Section IV.B.2.)

3. OTHER CONTRACTING ISSUES

(15) Contracting agencies like the Navy should institute procedures to ensure that the rationale for important contracting decisions is fully documented. (*See* Section IV.C.2.)

(16) The Federal Acquisition Regulations should be revised to provide clear guidance on the circumstances in which a contractor may be paid at the maximum allowable rate during performance on a contract when such payment will leave insufficient funds to complete the contract. (*See* Section IV.C.3.)

II. BACKGROUND AND OVERVIEW

A. The 8(a) Set-Aside Program

The 8(a) set-aside program was initiated by President Johnson in 1967, pursuant to the authority of the Small Business Act, to assist companies that provided jobs for the hard-core unemployed in ghetto areas. Beginning in 1969, the SBA changed the emphasis of the program to promoting viable businesses owned by socially and economically disadvantaged individuals.

To be eligible for the program, a company must be (a) at least 51% owned by individuals who (b) are socially and economically disadvantaged and who (c) control the company's management and daily business operations. In addition, an eligible firm must meet size standards applicable to all small business programs.

Under regulations promulgated by the SBA, any individual who is Black, Hispanic, Native American, or Asian American is presumed to be socially disadvantaged. An individual's economic disadvantage is determined on the basis of his or her financial condition and the access to credit and capital of the business that he or she owns. The SBA's rules and regulations include detailed evaluation forms for determining economic disadvantage.

Under a 1981 amendment to the Small Business Act, each 8(a) firm is given a "Fixed Program Participation Term", during which it is eligible to receive 8(a) contracts. Upon completion of its term (including extensions that may be granted by the SBA), a company automatically "graduates" from the program and becomes ineligible for additional 8(a) contracts. If a company fails to meet 8(a) eligibility requirements at any time, it may be terminated from the program prior to graduation.

As the program is currently structured, 8(a) contracts are awarded on a sole-source basis for a "Fair Market Price" agreed upon by the firm, the SBA, and the contracting agency. Most 8(a) companies do their own marketing and seek SBA support only after they have identified a potential 8(a) contract. In some cases, however, the SBA itself identifies a potential 8(a) contract and nominates an eligible firm as the SBA's candidate. In either case, the SBA enters a contract with the contracting agency and then subcontracts the contract to the 8(a) company on a sole-source basis.

The SBA is authorized to assist 8(a) companies in the performance of their contracts. The forms of assistance the SBA can provide include: (a) advance payments—a form of interest-free loan to finance contract performance; (b) Business Development Expense (BDE) grants to finance the purchase of capital equipment needed for the performance of 8(a) contracts; and (c) professional managment services.

The 8(a) program has suffered from abuses almost since its inception. Past scandals have involved the use of "front companies" by

non-disadvantaged entrepreneurs, the sale of 8(a) firms to Fortune 500 companies, and the use of advance payments for purposes completely unrelated to the financing of 8(a) contracts. There have also been complaints that a handful of successful companies have monopolized most of the assistance awarded under the program. The Wedtech case is the latest, and perhaps the most extraordinary, of the scandals. Legislation addressing many of the problems highlighted by the Wedtech case is currently pending before the Senate.

B. A Brief History of Wedtech

1. THE BEGINNINGS

The Welbilt Electronic Die Corporation (later Wedtech) was founded in the South Bronx in 1965 by John Mariotta, an American citizen of Puerto Rican descent. In 1970, Fred Neuberger, a non-disadvantaged individual, became Mr. Mariotta's partner and Welbilt's co-owner with one-third of the company's stock. In September 1981, Mario Moreno, an Hispanic American, joined Welbilt as Treasurer. At that time, Messrs. Mariotta and Neuberger each held 45.5% of Welbilt's stock, while Mr. Moreno held the remaining 9%.[1]

When Welbilt entered the 8(a) set-aside program in 1975, the company had annual sales of about $200,000. By 1978, Welbilt had grown to fifty employees and $1.5 million of sales—but virtually all of the growth came from 8(a) contracts, and the SBA staff was already warning that the company was becoming over-dependent on the program. In 1979, Welbilt received its first multi-million dollar 8(a) contract—for replacement kits on armored personnel carriers—with the help of the law firm of Biaggi & Ehrlich. The company moved to a new building and increased its payroll to about 120.

2. THE ARMY ENGINE CONTRACT

In July 1980, Welbilt was designated the SBA's candidate for an Army engine contract, which the company believed could bring it as much as $200 million. Welbilt ran into trouble as soon as it submitted its first proposal in eary 1981—$99 million for a segment of the contract that the Army believed should cost $19 million or less. Welbilt offered to perform the contract for $38 million, but the Army still considered the proposal to be out of the ballpark.

In 1981 and 1982, Welbilt pressed its case for the Army engine contract, arguing that the contract would bring needed jobs to the South Bronx. Welbilt officials and consultants pointed out that the South Bronx was a devastated urban area with high unemployment and that the President had promised, on a New York campaign trip in 1980, to work with private enterprise to bring jobs to the area.

In March 1981, Philip Sanchez of the Latin American Manufacturers' Association (LAMA) sent an "action memorandum" to Presidential advisor Lyn Nofziger introducing Wedtech. Three months later, the company persuaded E. Robert Wallach, a San Francisco

[1] August 21, 1981 Shareholders' Agreement. Wedtech does not appear to have informed the SBA of this ownership change, and Mr. Moreno did not file a personal eligibility statement with the SBA until November 24, 1983.

attorney and a close friend of then-White House Counselor Edwin Meese III, to lobby Mr. Meese on Welbilt's behalf. Over the next year, Mr. Mariotta appeared at the White House on several occasions. In August 1981, January 1982, and May 1982, members of the White House staff called meetings with the Army and the SBA at which they argued on behalf of Welbilt.

In June 1982, the Pentagon overrode objections of the Army Troop Support Command and directed the command to negotiate a contract with Welbilt. James Sanders, the Administrator of the Small Business Administration, signed a letter to Welbilt guaranteeing the company $3 million in SBA Business Development Expense (BDE) grants and $2 million in SBA advance payment loans. HUD offered an additional million dollar Urban Development Action Grant to assist the company in acquiring necessary facilities. The $27 million engine contract was awarded to Welbilt on September 27, 1982.

3. THE ELIGIBILITY DECISIONS

In August 1983, Welbilt changed its name to Wedtech and raised $27 million through a public stock sale. As a result of this sale, Wedtech acknowledged both in internal memoranda and in official company documents filed with the SEC that it was no longer 51% owned by disadvantaged individuals, as required by SBA regulations. Moreover, the millions of dollars obtained through the stock sale by Wedtech and its owners should have raised substantial questions as to whether the company continued to qualify as "economically disadvantaged." At about the same time, Wedtech's 8(a) program term expired. Instead of simply letting Wedtech "graduate," however, the SBA issued a "bridge letter", temporarily extending Wedtech's term until all eligibility issues could be resolved.

In December 1983, Wedtech's owners undertook a so-called "stock sale" which, they claimed, restored majority ownership to Mr. Mariotta. No stock was actually delivered to Mr. Mariotta in this transaction, no money changed hands, no payments were due for two years, the price for the sale was not fixed, and there was no penalty for a failure to pay other than the return of the stock. Nonetheless, the SBA district and regional offices approved the transaction within a day of Wedtech's submittal of the stock purchase agreement and supporting documentation. The national SBA office approved the transaction later the same month and granted Wedtech a three-year extension of its 8(a) program term.

4. THE NAVY PONTOON CONTRACT

In the summer and fall of 1983, several 8(a) companies became aware that a Navy contract for as much as $500 million of pontoon causeways was likely to be awarded in the near future. These companies geared up for the program and contacted the SBA, which encouraged them to pursue the requirement. Initially, the Navy refused to set the contract aside under the 8(a) program on the grounds that the contract was too complex and strategically important to be handled by an 8(a) company.

In September or October, Wedtech also became interested in the contract. At this time, the company was already behind schedule in

its efforts to produce engines under its Army contract, was severely overdependent upon 8(a) contracts, had no facilities to build pontoons, and should have been ineligible for continued participation in the 8(a) program as a result of its public stock sale.

In December, the Navy reversed its position and agreed to set-aside the pontoon contract for an 8(a) firm. In January, the SBA abandoned its plan to use multiple contractors and made Wedtech its candidate for the entire contract. On April 17, 1984, Wedtech was awarded a $24 million pontoon contract, with options worth more than $100 million. Wedtech officials state that their consultants and political allies lobbied high officials in the SBA and the Navy to award them the contract. SBA and Navy officials deny that they were improperly influenced by Wedtech or its consultants and maintain that their decisions were made on the merits.

5. THE COLLAPSE OF WEDTECH

The $6 million in federal grants and interest free loans awarded to Wedtech for the Army engine contract proved insufficient to keep the company on sound financial footing, even when added to $4 million of federal assistance made available to the company for other projects. In early 1983, the SBA and the Army learned that Wedtech was not paying its vendors, who were starting to demand cash in advance, thereby slowing down production and deliveries.

Wedtech officials have pled guilty in federal court to charges that they attempted to cover these cash flow problems by falsifying progress payment requests to accelerate government payments. At the same time, SBA and Army documents indicate that the company began to use employee withholding money improperly to cover corporate expenses. Deficiencies in the company's procurement and production systems were so severe that the Defense Department had to send in a team of experts for several months in the winter and spring of 1983 to straighten them out. In August 1983, Wedtech temporarily resolved its financial problems with a public stock offering. After its initial difficulties, Wedtech managed to produce acceptable engines, but the company experienced extreme cost overruns and never came close to meeting the Army's schedule.

Wedtech experienced similar problems with the pontoon contract. Wedtech had to build a facility and put together a work force from scratch, "an almost impossible task," according to several SBA and Navy officials, given the Navy's stringent schedule needs. The company had trouble getting qualified welders, getting power into the facility, meeting environmental requirements, and getting approval for deviations they wanted to make from the contract specifications. The first pontoons built by Wedtech were described by the ranking Defense Department contract administrator in the New York area as "terrible"—the welds were bad and the corners weren't even square. Again, the Department of Defense had to send in a team of experts to straighten out problems in Wedtech's management and quality control systems. While many companies experience production and schedule difficulties on federal contracts, the problems experienced by Wedtech appear to have been extreme in both their pervasiveness and their persistence.

A year and a half after the award of the contract, Wedtech began to produce acceptable pontoons, but the company's performance was almost a year late and millions of dollars over budget. Wedtech's management tried to hold the company together with an additional $30 million line of credit and three more public stock offerings. When the company's legal problems began to surface in the press at the end of 1986, however, the company found itself unable to raise additional money and declared bankruptcy.

C. Wedtech's General Ally Structure

Former Wedtech officials attribute their success in remaining in the 8(a) program and garnering the Army engine and Navy pontoon contracts to efforts of the company's well-placed and highly-paid consultants and their political contacts. In a November 12, 1984 memorandum to Wedtech's officers, E. Robert Wallach referred to these consultants and contacts as Wedtech's "general ally structure." Mr. Wallach expressed his belief as to the power of this ally structure in a second memorandum to Wedtech officials on December 10:

> [T]he more power we have, and the more we are confident of our resources, the less we should have to say about them. The subject is not our ability to do it, but actually doing it, without any expression of it being done.

It is not illegal or improper for a federal contractor to hire a consultant or a Washington lobbyist, and it is not illegal or improper—except in narrowly defined circumstances—for such consultants and lobbyists to contact federal officials on behalf of a client. However, the array of consultants and contacts assembled by Wedtech—a supposedly "disadvantaged" company—is exceptional.

First, Wedtech officials allege, they made use of Steven Denlinger of the Latin American Manufacturer's Association. Mr. Denlinger provided an entree to White House aides Henry Zuniga, Wayne Valis, and Pier Talenti, all of whom pushed for the award of the Army engine contract to Wedtech. In addition, Mr. Denlinger introduced Wedtech to Richard Ramirez, the head of the Navy's 8(a) office—who later went to work as a consultant to Wedtech. Mr. Denlinger also met regularly with Robert Saldivar, the second ranking official in the SBA's 8(a) office, who later became Mr. Ramirez' successor at the Navy.

Second, Wedtech hired the law firm of Biaggi & Ehrlich, in substantial part, because of the firm's connection to Congressman Mario Biaggi. Former Wedtech officials allege that Mr. Biaggi prevailed upon Congressman Joseph Addabbo and Senator Alphonse D'Amato to contact the Pentagon on Wedtech's behalf. In addition, it appears that the Biaggi & Ehrlich law firm provided Wedtech with easy access to top officials in the New York regional office of the SBA, including the Regional Administrator, Peter Neglia. Biaggi & Ehrlich received more than $800,000 in cash and millions of dollars worth of stock from Wedtech for their services.

Third, Wedtech contacted Mr. Wallach, a San Francisco attorney and a close friend of Edwin Meese III, then Counselor to the President. Mr. Wallach contacted Mr. Meese and his deputy, James Jenkins, on numerous occasions on behalf of Wedtech. Mr. Meese asked his staff to ensure that Wedtech received a "fair hearing" on

the Army engine contract and Mr. Jenkins convened a May 19, 1982 meeting of agency officials on that subject. In 1985, at the invitation of Mr. Wallach, Mr. Meese entered a limited partnership with W. Franklyn Chinn, a Wedtech consultant and later a director of the company. Mr. Chinn and his associate, Rusty London, were paid more than $1.4 million in cash and stock in 1985 and 1986 for their services to Wedtech. Also in 1985 and 1986, Mr. Jenkins worked for Wedtech as a consultant and a lobbyist, and was paid almost $170,000 for approximately 18 months work. Mr. Wallach worked for Wedtech without pay in 1981 and early 1982, but ultimately received almost $1.5 million in cash and stock from the company.

Fourth, Wedtech retained the firm of Nofziger and Bragg Communications shortly after Mr. Nofziger left the White House. Mr. Nofziger and Mr. Bragg contacted numerous federal officials on behalf of Wedtech, including SBA Administrator James Sanders and Deputy Administrator Don Templeman; Army Secretary John Marsh and Assistant Secretary Jay Sculley; and Navy Secretary John Lehman, Assistant Secretary Everett Pyatt, and Principal Deputy Assistant Secretary Wayne Arny. Messrs. Nofziger and Bragg received almost $900,000 in cash and stock from Wedtech for their services.

From 1982 to 1986, Wedtech paid more than five million dollars for the assistance of these consultants—a truly extraordinary sum for a firm that purported to be "economically disadvantaged."

D. The Subcommittee's Investigation and Hearings

The Subcommittee's investigation of Wedtech began in early November 1986 with letters to the Army, the Navy, and the Small Business Administration requesting documents and asking for explanations of the decisions made by these agencies with regard to Wedtech. The three agencies responded with letters and documents in December, January, February, and March.

Since this time, the Subcommittee staff has reviewed more than thirty boxes of documents from Army, Navy, and SBA files, as well as documents obtained from former government officials, Wedtech, and former Wedtech lawyers, consultants, and competitors. In November 1987, the Subcommittee staff reviewed White House documents relating to Wedtech. Pursuant to an agreement with the White House Counsel's office, copies of documents which were sent to, or received from, sources outside the White House were made available to the Subcommittee. Documents that were internal to the White House were shown to the Subcommittee staff for purposes of taking notes, but actual copies were not provided to the Subcommittee. Five documents were not disclosed to the Subcommittee because of a claim of privilege by the White House Counsel's office.

In addition, the Subcommittee staff has interviewed more than 150 individuals, including Army, Navy and SBA officials, former members of the White House staff, Wedtech officers, Wedtech consultants, and Wedtech competitors. In early 1987, four former Wedtech officials—Fred Neuberger, Mario Moreno, Lawrence Shorten and Anthony Guariglia—pled guilty to charges of bribing federal,

state and local government officials, accepting kickbacks, and defrauding the government through false claims and false statements. Since that time, these four individuals have been cooperating with federal and state prosecutors in ongoing investigations of Wedtech-related offenses. Mr. Neuberger was interviewed by the Subcommittee staff on October 9, 1987. Mr. Moreno was interviewed by the Subcommittee staff on September 17 and October 9, 1987.

Several potential witnesses invoked their 5th Amendment privilege against self-incrimination as a basis for refusing to be interviewed or to testify before the Subcommittee. These individuals included former Navy Small and Disadvantaged Business officer Richard Ramirez, former SBA New York Regional Administrator Peter Neglia, former Wedtech President John Mariotta, and former Wedtech consultants Franklyn Chinn, Rusty London, and Stephen Denlinger. Lyn Nofziger and Mark Bragg, who stood trial in early 1988 for their role in assisting Wedtech, also declined to be interviewed. The Subcommittee did not consider immunity for any of these individuals to avoid interfering with ongoing criminal investigations.

In September 1987 the Subcommittee began its Wedtech hearings with two days of hearings on Wedtech eligibility issues and two days of hearings on the Navy pontoon contract. On September 9 and 10, the Subcommittee heard the testimony of former SBA Administrator James Sanders, former Deputy Administrator Donald Templeman, General Counsel Robert Webber, Deputy Regional Administrator Aubrey Rogers, Associate Regional Administrator Edric Rose, Regional Counsel Jack Matthews, District Counsel David Elbaum, and Wedtech lawyer Martin Pollner. On September 29 and 30, the Subcommittee heard the testimony of Assistant Secretary of the Navy Everett Pyatt, former Principal Deputy Assistant Secretary Wayne Arny, Admiral Thomas J. Hughes, Jr., Captain David C. de Vicq, Colonel Don Hein, former SBA Associate Administrator Henry Wilfong, and former Deputy Associate Administrator Robert Saldivar.

Additional hearings dealing with the award of the Army engine contract to Wedtech were delayed because of concerns expressed by Independent Counsel James McKay that such hearings might interfere with the trial of former Wedtech consultants Lyn Nofziger and Mark Bragg. In light of extensive public testimony at the trial of Messrs. Nofziger and Bragg, the Subcommittee decided not to hold additional hearings on this contract.

Various aspects of the Wedtech case are also under investigation by the Independent Counsel, three United States Attorneys, the Labor Department's Office of Racketeering and Enforcement, the SBA Inspector General, the Defense Criminal Investigative Service, and others. The Subcommittee has endeavored to examine the following questions: What role does political pressure play in the procurement process? Do the current ethics laws need to be strengthened to avoid improper political influence? Does the current structure of the 8(a) program invite such interference? Should 8(a) contracts be awarded on a competitive, rather then sole-source, basis? Should program eligibility requirements be strengthened? How can the process be changed to avoid future Wedtechs?

III. EVIDENCE RECEIVED BY THE SUBCOMMITTEE

A. The Army Engine Contract

1. THE ORIGINS OF THE CONTRACT

a. The Set-Aside of the Contract and the Selection of Wedtech.—Military Standard Engines (MSE's) are small engines used by the Army to power portable field generators, compressors, heaters and lubrication and service units. There are six different sizes of MSE's, ranging from 1.5 horsepower to 30 horsepower. The six-horsepower MSE built by Wedtech is a four-cylinder, air-cooled gasoline engine similar to a lawnmower engine, though it must comply with more stringent requirements to ensure high reliability and long life. The MSE engine is designed with interchangeable parts to be completely rebuildable, and must operate at temperatures down to 25 degrees below zero.

Military Standard Engines are an Army stock item purchased by the Troop Support and Aviation Materiel Readiness Command (TSARCOM) [1] for use in the field by other commands. TSARCOM is a buying command, headquartered in St. Louis and responsible for maintaining a depot system by purchasing stock items in large quantities. When the stock in warehouses around the world begins to diminish, officials in the field notify TSARCOM, which orders more supplies.

Beginning in the mid-1950's, the Army purchased large quantities of MSE's from Chrysler Outboard Corporation and Continental Motors. By 1977, when Chrysler completed its final production run, there were more than 120,000 MSE's in the field and in warehouses and the Army began to consider the possibility of changing over to commercial engines or developing its own updated engine. Army officials have told the Subcommittee staff that snags developed in the planning process, however, and warehouse supplies began to dwindle without the development of a new engine.[2] By 1978, the Army decided that it would need one more production run of MSE's to maintain its stocks while a new procurement plan was developed.

In late 1978, Major General Richard Thompson, the Commander of TSARCOM, suggested to other Army officials that the MSE procurement might be appropriate for set-aside under the Section 8(a) program for small disadvantaged businesses.[3] In the fall of 1979, TSARCOM contacted a number of companies with experience in engine production to determine if any were interested in providing manufacturing expertise to an 8(a) company in a teaming arrange-

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[1] TSARCOM has since been replaced by the Army Troop Support Command (TROSCOM).

[2] May 7, 1987 interview of Col. Spaulding; May 14, 1987 interview of Dr. Keenan.

[3] May 9, 1980 Chronology of Events, Proposed 8(a) Contract for Military Standard Engines (MSE). In 1981 and 1982, the Army awarded more 8(a) contracts than any other federal agency. Testimony of Mr. Stohlman (Nofziger Tria[illegible] at 2662.

ment to perform the contract. TSARCOM's proposal was rejected by Chrysler, General Motors, Allis-Chalmers, Emerson Electric, Ford Motor Company, General Electric, Teledyne Wisconsin Motors, Brunswick Corporation and Koehler Corporation. In early 1980, the International Services Division of Avco Corporation, the last candidate contacted by TSARCOM, agreed to sponsor an 8(a) company in building the engines.[4]

In February 1980, Avco officials visited the Detroit area to survey potential contractors and proposed that the contract be performed by Mexican Machining, Inc.[5] Mexican Machining was rejected by the SBA because it was not a certified 8(a) company. In early March, the SBA commissioned the Latin American Manufacturers' Association (LAMA) to conduct a "feasibility study" on the engine contract.[6] At LAMA's suggestion, the SBA designated Hartec Enterprises Inc. as its candidate for the MSE contract.[7] Hartec was owned and operated by Jose Aceves, who had recently resigned as LAMA's President.

At the same time, the SBA designated the MSE contract for performance under the new Section 8(a) "pilot program." [8] Under the regular 8(a) program, the procuring agency has discretion to select contracts for performance by 8(a) firms; under the pilot program, this authority was transferred to the SBA.[9] The pilot program was intended to help 8(a) contractors break away from the construction and services contracts typically reserved for the program by enabling the SBA to designate more sophisticated contracts.[10] The Army initially objected to SBA's designation of the MSE contract for the pilot program on the grounds that the contract was already under consideration for set-aside under the regular 8(a) program,[11] but eventually assented to the reservation.[12]

In May 1980, TSARCOM conducted a preliminary survey of Hartec and found that the company had no facilities, no personnel, no production plan, and no plans for the acquisition of facilities and equipment. For these reasons, the Army concluded that Hartec's experience, facilities and plans were inadequate to the job.[13] Hartec attempted to overcome these criticisms by bringing in another small disadvantaged business, the Welbilt Electronic Die Corporation (later Wedtech), for assistance.[14] (Consistent with contem-

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[4] May 9, 1980 Chronology of Events, Proposed 8(a) Contract for Military Standard Engine (MSE).

[5] February 19, 1980 Avco memorandum from Mr. Imhoff to Mr. Jones; May 19, 1980 letter from Ms. Watts to Mr. Browne.

[6] March 7, 1980 Memorandum for the Record by Mr. Clark (TSARCOM Small Business officer).

[7] *See* May 19, 1980 letter from Ms. Watts to Mr. Browne; June 26, 1980 letter from Ms. Watts to Mr. Denlinger.

[8] March 25, 1980 telephone call from Mr. Saldivar to Mr. Ream, as reflected in May 9, 1980 Chronology of Events; April 30, 1980 letter from Mr. Browne to Secretary of the Army Clifford Alexander.

[9] Public Law 95-507, Section 202(a)(1) (1978).

[10] *See* Hearing Record, Part 1 at 127, 141 (Testimony of Mr. Sanders).

[11] May 19, 1980 letter from Ms. Watts to Mr. Browne; June 2, 1980 Memorandum for the Record from Ms. Watts regarding May 30, 1980 meeting with LAMA and Hartec.

[12] June 23, 1980 and September 2, 1980 memoranda from Ms. Watts to TSARCOM.

[13] June 6, 1980 letter from Ms. Watts to Mr. Browne.

[14] May 28, 1980 letter from Mr. Aceves to Dr. Keenan. A schedule of consulting fees that Welbilt filed with the SBA in November 1982 indicated that the company paid Hartec $21,000 in the first nine months of that year.

poraneous documents, Wedtech will be referred to as "Welbilt" throughout the text of this section, and as "Wedtech" in later sections of the report).

On August 28, 1980, after several months of dispute with the Army, the SBA formally withdrew Hartec as its candidate for the engine contract and substituted Welbilt.[15] Two weeks later, the SBA's New York district office submitted a formal written justification for the nomination of Welbilt. The justification memorandum stated that Welbilt had shown "adequate performance in the areas of managerial, technical, production and financial capability and capacity" and that its facilities, personnel and financial capabilities were "sufficient at this time." [16] The memorandum did not mention Welbilt's location in the South Bronx or any other rationale for the selection.

By the time the SBA selected Welbilt as its candidate for the MSE contract, almost two years had lapsed since the Army's initial decision to explore an 8(a) set-aside. Dr. Tom Keenan, the TSAR COM procurement director, told the Subcommittee staff that TSARCOM was starting to receive complaints about short supply in the field and the 8(a) program had already been given two chances to find a qualified firm, so it was time to go competitive and give established engine manufacturers a shot at the job.

Dr. Keenan told the Subcommittee staff that as a result of prodding from SBA and LAMA, he reluctantly decided to give them "one more try" and agreed to take a look at Welbilt. On June 25, 1980, two TSARCOM officials—Tom Cygan and Jim Corwin—were sent to the South Bronx to conduct a preliminary review of Welbilt's facilities. Messrs. Cygan and Corwin told the Subcommittee staff that they toured a two or three story building with a lot of empty space and one or two sophisticated numerical control metal-cutting machines. Mr. Corwin stated that he was astounded that this company was talking about building a four-cylinder lawnmower-type engine that could pass a 1500-hour quality test. Dr. Keenan told the Subcommittee staff he remembered receiving a report that Welbilt was very good "for the work they were doing at the level they were doing it," but was not capable of taking on the much larger engine contract without serious adjustment problems.

Nonetheless, as required by the 8(a) pilot program upon request of the SBA, on October 3, 1980, TSARCOM formally notified the SBA of its engine requirements and sent a bid solicitation to the SBA.[17] The next month, TSARCOM estimated the Fair Market Price (FMP) to produce the 13,100 six horsepower engines covered by the solicitation.[18] TSARCOM price analyst Jim Beckham took

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[15] August 28, 1980 letter from Mr. Browne to Secretary Alexander.

[16] September 11, 1980 memorandum from Ms. Sanchez to Mr. Rose.

[17] October 3, 1980 letter from Dr. Keenan to Mr. Quigley. *See* September 2, 1980 memorandum from Ms. Watts to TSARCOM (directing reservation of engine contract for negotiation with Welbilt under the pilot program).

[18] TSARCOM initially proposed to contract with Welbilt for 50 engines, and enter additional contracts for as many as 30,000 engines (1.5, 3, and 6 horsepower) if Welbilt performed successfully. October 3, 1980 letter from Dr. Keenan to Mr. Quigley. After Welbilt stated that it would need a firm commitment for a larger number of engines to amortize its tooling costs, TSARCOM agreed to place its entire requirement for 13,100 six-horsepower engines in a single solicitation. Minutes of November 3, 1980 Pre-Proposal Conference in St. Louis (from Wedtech files).

the unit price from the Army's most recent engine contract with Chrysler and applied an inflation factor of 82.3% to calculate a unit cost of $1,485 per engine, for an FMP of $19 million.[19]

On February 27, 1981, Welbilt submitted a proposal, which had been prepared by Avco, to build the engines for $99.9 million. Contract pricing specialist Jim Beckham told the Subcommittee staff that this proposal provoked "hysterical laughter" at TSARCOM and that the general reaction was "[T]his is absurd, let us out of this damn pilot program." Dr. Keenan stated that the Avco/Welbilt price was "not only laughable, but outrageous." On March 17, TSARCOM formally requested that the Secretary of the Army seek removal of the engine contract from the 8(a) pilot program. As the letter explained, TSARCOM had pursued a set-aside of the engine contract for more than two years, Army inventories were entering "a severe negative position" and Welbilt's proposed price was "outside the realm of possibility." [20]

Over the next month, Welbilt dropped its proposed price first to $45 million [21] and then to $38 million.[22] From the Army's point of view, however, a $38 million proposal was no more acceptable than a $99 million proposal. TSARCOM's chief negotiator on the engine contract, Joe Murray, stated in an interview with the Subcommittee staff that both Welbilt's first, $99 million proposal and its later, $38 million proposal were "exorbitant." [23] Moreover, contract price specialist Jim Beckham told the staff, Welbilt's reduced proposals came in without any backup data or explanatory materials—they were "just cover sheets with another dollar figure and absolutely no backup." Notes of a 1981 meeting between TSARCOM and Pentagon officials indicate Dr. Keenan's concern that Welbilt's proposed tooling costs were less than the company's actual costs to gear up from scratch and build the engines, which could be as high as $57 million.[24] On April 13, 1981, TSARCOM formally rejected Welbilt's $38 million proposal.[25]

b. Wedtech's Efforts to Overcome the Army's Resistance.—Welbilt's officials appealed for political assistance on the basis that the engine contract would mean employment and hope in a devastated part of the South Bronx. As Mr. Mariotta explained in an April 14, 1981 letter to the Secretary of the Army:

> [The] South Bronx [is an] enclave of high unemployment and low expectations . . . . Eighty percent of our people have been and otherwise still would be on welfare. They have been stigmatized as "obviously unemployable", as "machete swingers", as "spear chuckers". We work metal here. We also erase stigmata.

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[19] November 12, 1980 memorandum for the record by Mr. Beckham. An October 30, 1980 SBA file memorandum indicates that Welbilt and the SBA were expecting a contract of as much as $200 million. The memo quotes the SBA's Jesse Quigley as stating that the SBA was "not frightened by the $200M mark, but for appearances sake would like it dropped a little below that mark."

[20] March 17, 1981 memorandum from Lt. Col. Andrews to Army small business office.

[21] March 27, 1981 memorandum from Ms. Mayfield to Dr. Keenan.

[22] April 2, 1981 letter from Mr. Quigley to Mr. Cygan.

[23] *See* Testimony of Dr. Sculley (Nofziger Trial) at 2869–70; Testimony of Mr. Stohlman (Nofziger Trial) at 2773; May 24 1987 interview of Mr. Stohlman; May 21, 1987 interview of Ms. Watts; May 7, 1987 interview of Col. Spaulding; May 14, 1987 interview of Dr. Keenan; May 11, 1987 interviews of Mr. Beckham and Mr. Cygan.

[24] Handwritten notes of 9 Sept. 1981 meeting attended by Dr. Keenan, Messrs. Dausman and Stohlman, Ms. Watts, Lt. Col. O'Brien, and Col. Spaulding.

[25] April 13, 1981 letter from Lt. Col. Andrews to Mr. Quigley.

Mr. Mariotta's letter stated that the engine contract would create 300 jobs in the South Bronx; by taking these people off welfare, he claimed, Welbilt would save the government $24 million.

Welbilt officials felt that they were unfairly branded as incompetent on the basis of a proposal that they had not even been allowed to review before it was sent to the Army.[26] In his letter to Secretary Marsh, Mr. Mariotta pointed out that the initial $99 million proposal was prepared by Avco and blamed the Army for selecting Avco to help Welbilt on this contract. Former Welbilt Executive Vice President Mario Moreno and former in-house counsel Edward McCarthy have told the Subcommittee staff that they and other Welbilt officials believed that Avco's initial proposal was purposefully designed to push Welbilt out of the picture so that Avco could get the contract.[27] Mr. McCarthy stated that the Army was "stonewalling" and negotiating "in bad faith." Dr. Keenan, the TSARCOM procurement director, was seen as the "villain" in this conspiracy.[28]

In April 1981, several Congressmen contacted the Army to inquire about the status of the engine contract. On April 13, Representative Manuel Lujan of New Mexico wrote to the Commander of the Army Materiel Command to request "serious consideration" of the Welbilt proposal. On April 16, Senator Alphonse D'Amato of New York wrote to Secretary of the Army John Marsh to express the support for Welbilt's efforts. On April 21, Representative William Dickinson of Alabama wrote to the Army's Legislative Liaison to urge that the Welbilt proposal be audited. This letter-writing continued in the summer with letters to Secretary Marsh from Representative Jim Courter of New Jersey, Representative Christopher Smith of New Jersey, and Representative Joseph Addabbo of New York.[29]

Several of these letters simply asked for consideration of the Welbilt proposal; others set forth social policy arguments favoring a set-aside. Senator D'Amato's letter, for example, urged personal consideration of the proposal by the Secretary in light of the "role a firm like Welbilt can play in revitalizing an economically devastated area like the Bronx."[30] Congressman Smith's letter made a similar point:

> I'm sure that you share my interest in seeing that the Reagan/Bush Administration reaps the benefit of low cost production of engines in a location which affords ancillary vast relief for welfare-supported, hard-core unemployed minority persons.[31]

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[26] Testimony of Mr. Denlinger (Nofziger Trial) at 2174–75.

[27] *See* Testimony of Mr. Moreno (Nofziger Trial) at 1946–49.

[28] October 16, 1987 interview of Mr. Epstein; *see* Testimony of Mr. Denlinger (Nofziger Trial) at 2175–76; Testimony of Mr. Moreno (Nofziger Trial) at 1947–48; Transcript of June 29, 1987 interview of Mr. Wallach at 35. So seriously did Welbilt take this theory that in early April 1981, the company hired a private investigator—Hal Lipset—to investigate Dr. Keenan. Former Welbilt officials Fred Neuberger, Mario Moreno and David Epstein have told the Subcommittee staff that this investigation was a failure; according Mr. Moreno, "we couldn't find anything wrong with him."

[29] August 14, 1981 letter from Rep. Courter to Secretary Marsh; August 17, 1981 letter from Rep. Smith to Secretary Marsh; August 25, 1981 letter from Rep. Addabbo to Secretary Marsh. *See* Testimony of Mr. Moreno (Nofziger Trial) at 1922–24.

[30] April 16, 1981 letter from Senator D'Amato to Secretary Marsh.

[31] August 17, 1981 letter from Rep. Smith to Secretary Marsh. In addition to this Congressional support, Deputy New York Mayor Karen Gerard and consultant Dickie Dyer wrote to Secre-

Continued

In addition, Secretary Marsh told the Subcommittee staff that he received numerous telephone calls from Congressmen about Welbilt and the engine contract. According to Robert Stohlmam, an official in the Assistant Secretary's office, the Army received several congressional inquiries a week on behalf of Welbilt in the Spring and Summer of 1981.[32]

The Army responded to these congressional expressions of interest on behalf of Welbilt by reiterating its intention to issue a fully competitive solicitation for the engine contract. In letters to Congressmen Dickinson and Courter, the Army stated that the Welbilt proposal was unreasonable in light of the fair market price, which had been estimated on the basis of previous competitive bidding.[33]

Also in the Spring of 1981, at the suggestion of a private investigator hired by Welbilt, Hal Lipset, Welbilt contacted E. Robert Wallach, a San Francisco attorney and a close friend of then-Counselor to the President Edwin Meese III.[34] Mr. Wallach, Mr. Lipset, and former Welbilt officials Fred Neuberger, Mario Moreno and David Epstein have all confirmed in interviews with the Subcommittee staff that Welbilt contacted Mr. Wallach because of his relationship with Mr. Meese.[35]

In an interview with the Subcommittee Chairman and staff, which was transcribed by a court reporter, Mr. Wallach described his relationship with Welbilt. In early April 1981, Mr. Wallach stated, he met with Welbilt officials, who gave him a tour of the Welbilt plant and "told [him] their life stories" over a three-hour lunch.[36] The Welbilt officials went on to explain "this history of their animosity with this man Keenan and their belief that they were being sabotaged by Keenan." [37] Former Wedtech Executive Vice President Mario Moreno told the Subcommittee staff that he also remembers a three-hour lunch, over which Welbilt officials told Mr. Wallach "what we wanted to do with the company." According to Mr. Moreno, Mr. Wallach just listened and said that he would talk to Mr. Meese. Although Welbilt later paid Mr. Wallach almost $1.5 million in cash and stock, Mr. Wallach stated in his interview that he did not think that his friendship with Mr. Meese or his work on the Army engine contract was a factor in Welbilt's decision to compensate him.[38]

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tary of Defense Caspar Weinberger and Secretary of the Army John Marsh on Welbilt's behalf. April 14, 1981 letter from Ms. Gerard to Secretary Weinberger; August 12, 1981 letter from Mr. Dyer to Secretary Marsh. One Senator, Robert Kasten of Wisconsin, wrote to Secretary Marsh to express support for a competitive procurement. June 26, 1981 letter from Senator Kasten to Secretary Marsh.

[32] Testimony of Mr. Stohlman (Nofziger Trial) at 2822.

[33] May 2, 1981 letter from Col. Corns to Rep. Dickinson; September 1, 1981 letter from Secretary Marsh to Rep. Courter.

[34] June 12, 1987 interview of Mr. Lipset; October 9, 1987 interviews of Messrs. Neuberger and Moreno; October 16, 1987 interview of Mr. Epstein.

[35] Transcript of June 29, 1987 interview of Mr. Wallach at 12; June 12, 1987 interview of Mr. Lipset; October 9, 1987 interview of Mr. Neuberger; October 9, 1987 interview of Mr. Moreno; October 16, 1987 interview of Mr. Epstein.

[36] Transcript of June 29, 1987 interview of Mr. Wallach at 34-35.

[37] Transcript of June 29, 1987 interview of Mr. Wallach at 35.

[38] Transcript of June 29, 1987 interview of Mr. Wallach at 11-12, 62-63. Mr. Moreno told the Subcommittee staff that Welbilt first agreed to pay Mr. Wallach at some time between January and May of 1982, although no payments were made until after the engine contract was awarded in September 1982. Mr. Wallach stated that he first discussed money with Welbilt in October or November 1982. Transcript of June 29, 1987 interview of Mr. Wallach at 7, 9-10, 14-16.

According to Mr. Wallach, Welbilt officials periodically informed him of the status of their efforts to get the Army engine contract over the next year and told him "[W]e would appreciate it very much if you would be sure that that information was known". Mr. Wallach stated that he took notes of these conversations and turned them into memoranda to Mr. Meese.[39] Over a period of less than a year, Mr. Wallach wrote at least 15 personal memoranda to the then-Counselor to the President regarding Welbilt's efforts to obtain the Army contract.[40] Mr. Wallach stated that he made no attempt to verify the information given to him by Welbilt officials before passing it on to Mr. Meese.[41]

Mr. Wallach said that he made five trips to Washington in 1981, speaking to Mr. and Mrs. Meese on each occasion. In addition to Welbilt, Mr. Wallach stated, he discussed a range of other subjects with Mr. Meese in this period.[42] In May 1982, Mr. Wallach stated, he rented an apartment in Georgetown to be closer to the Meeses.[43]

In his testimony at the 1988 trial of Lyn Nofziger and Mark Bragg, Mr. Meese stated that at the time he received Mr. Wallach's memoranda, he knew that Mr. Wallach was a Welbilt consultant, but did not know whether or not he was paid.[44] Mr. Meese testified that he scanned all of the material Mr. Wallach sent to him, but may have read as little as 10 percent carefully.[45] At a Subcommittee hearing on July 9, 1987, Mr. Meese testified that copies of these memoranda were sent both to his office and to his home to ensure that he would see them:

> Senator LEVIN. Was it at your suggestion he also sent them to your home as well as to your office?
>
> Mr. MEESE. I don't remember whether I suggested that. Probably, because I received a great deal of mail at that time at the office, something like a thousand letters a week. And so the idea was to be sure that I did get to see them through one route or the other.[46]

At about the same time, Welbilt asked the assistance of the Latin American Manufacturers' Association (LAMA) to gain access to other White House officials.[47] Welbilt President John Mariotta had been a member and a strong contributor to LAMA since the mid-seventies.[48] LAMA's then-President, Stephen Denlinger, acknowledged at the Nofziger trial that Welbilt "supplemented [his] income" in 1981 and 1982.[49]

In March 1981, LAMA consultant Philip Sanchez wrote an "Action Memo" to Presidential advisor Lyn Nofziger, in which he

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[39] Transcript of June 29, 1987 interview of Mr. Wallach at 14.

[40] Memoranda from Mr. Wallach to Mr. Meese dated May 11, 1981; May 13, 1981; May 19, 1981; June 18, 1981; July 6, 1981; July 16, 1981; August 3, 1981; August 3, 1981; August 31, 1981; October 5, 1981; Octobr 6, 1981; October 7, 1981; December 30, 1981; January 19, 1982; January 21, 1982.

[41] Transcript of June 29, 1987 interview of Mr. Wallach at 50.

[42] Transcript of June 29, 1987 interview of Mr. Wallach at 40–42.

[43] Transcript of June 29, 1987 interview of Mr. Wallach at 26–29.

[44] Testimony of Mr. Meese (Nofziger Trial) at 3285, 3307.

[45] Testimony of Mr. Meese (Nofziger Trial) at 3285.

[46] Office of Government Ethics Review of the Attorney General's Financial Disclosure, Hearing Record at 28 (July 9, 1987).

[47] Testimony of Mr. Denlinger (Nofziger Trial) at 2001–02.

[48] October 9, 1987 interview of Mr. Moreno; Testimony of Mr. Denlinger (Nofziger Trial) at 1999.

[49] Testimony of Mr. Denlinger (Nofziger Trial) at 2002.

emphasized Welbilt's location in the South Bronx and Mr. Mariotta's efforts to build the company through the free enterprise system. Mr. Sanchez went on to state that Mr. Mariotta was an advocate of the Administration's policies, and to recommend that Mr. Mariotta be invited to the White House for a photo session with the President. There does not appear to be any record of a White House response to Mr. Sanchez' recommendation at that time.[50]

Several months later, beginning in June or July 1981, LAMA President Stephen Denlinger contacted White House aides Wayne Valis, Pier Talenti, Henry Zungia, Dan Smith, Thelma Duggan, and Diane Lozano on behalf of Welbilt.[51] Mr. Denlinger testified at the Nofziger trial that Welbilt's location in the South Bronx was an important point in his efforts to persuade White House aides to assist the company:

> Well, the South Bronx provided—it was a good opportunity from my point of view with respect to working with the White House staff because the President had made a campaign stop in the South Bronx and had made what we felt was a commitment to try to develop the South Bronx, and so we felt that—I felt that here was an excellent opportunity to do something, a minority firm that was doing well, doing good things, hiring the hard-core unemployed, and by golly, this should be worthy of some attention.[52]

Mr. Denlinger also testified that Welbilt paid for a quarter page newspaper ad in support of the President's 1981 tax bill as "part of the overall positive environment that we were seeking to create in support of the Welbilt effort." [53]

Mr. Denlinger testified that the first White House aide he contacted on behalf of Welbilt was Wayne Valis.[54] In an interview with the Subcommittee staff, Mr. Valis explained that his primary responsibility at the White House was to build a coalition in support of the President's tax and budget proposals. Mr. Valis stated that he was contacted by Mr. Denlinger and LAMA Chairman Fernando De Baca in July 1981. According to Mr. Valis, Mr. De Baca, who had served with him on the White House staff in the Ford Administration, reminded Mr. Valis of LAMA's support for President Reagan's tax and budget proposals and requested assistance for Welbilt. Mr. Valis told the Subcommittee staff that he decided to help Welbilt because LAMA had been "very, very supportive" of the Administration's policies and had worked extremely hard in support of the Administration's tax and budget proposals.[55]

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[50] In October 1981, Mr. Sanchez met with Mr. Nofziger in his White House office to discuss, among other issues, Welbilt. October 18, 1981 letter from Mr. Nofziger to Mr. Sanchez. Following this meeting, Mr. Nofziger sent a memorandum to Elizabeth Dole, then the head of the White House Office of Public Liaison, stating that Mr. Sanchez' ideas were "great"—"Especially the South Bronx idea." Mr. Nofziger went on to suggest that his assistant, Pier Talenti, should work with the Office of Public Liaison on these ideas. October 15, 1981 memorandum from Mr. Nofziger to Ms. Dole.

[51] Testimony of Mr. Denlinger (Nofziger Trial) at 2004, 2006, 2008. Mr. Denlinger has testified that his initial conversations with these White House aides were about Hispanic issues and the Administration's outreach to ethnic minorities. Over time, however, about half of Mr. Denlinger's contacts with the White House—including most of his contacts with Mr. Talenti and Mr. Zuniga—involved Welbilt and the Army engine contract. *Id.* at 2119–21.

[52] Testimony of Mr. Denlinger (Nofziger Trial) at 2004.

[53] Testimony of Mr. Denlinger (Nofziger Trial) at 2116.

[54] Testimony of Mr. Denlinger (Nofziger Trial) at 2004.

[55] In addition, Mr. Valis stated that he was concerned that "we weren't doing things for small business" and that the Administration was "closely identified with the big guys."

Mr. Denlinger testified that he also contacted Pier Talenti—then an unpaid staffer in the Office of Political Affairs headed by Mr. Nofziger—in July 1981 and invited him to visit Welbilt's plant in the South Bronx.[56] Mr. Talenti told the Subcommittee staff that he visited Welbilt with Mr. Denlinger in August 1981 at his own expense. Mr. Talenti stated that Welbilt was located in an area that was "really the worst of the worst," but had "unbelievable equipment" and was "producing first, first class work." After what Mr. Talenti described as a strong sales pitch from Welbilt officials, he decided that an award to Welbilt would have been a "double success"—it would help a distressed area and fulfill an election promise made by both Ronald Reagan and Jimmy Carter. According to Mr. Talenti, he told Welbilt officials that he would look into the matter and "see what can be done." [57]

During Mr. Talenti's visit, former Welbilt Vice President Mario Moreno testified at the Nofziger trail, Welbilt officials discussed the need to "bring[ ] contracts to ghetto areas like the South Bronx to create jobs and [an] industrial base." According to Mr. Moreno, Mr. Talenti stated that the White House had a strong interest in promoting such development in ghetto areas, dating back to President Reagan's campaign promise in the South Bronx, and that Mr. Nofziger had placed him in charge of "trying to help to get this engine contract to Welbilt Corporation." [58] Mr. Moreno testified that Welbilt officials were greatly encouraged by Mr. Talenti's visit because of the indication "that there were people in higher places in the White House trying to help us to get this contract." [59] Mr. Talenti stated in his interview with the Subcommittee staff that Mr. Nofziger was not aware of his effort on behalf of Welbilt.

2. THE AUDIT OF WEDTECH'S PROPOSAL

a. The First Attempt to Withdraw the Set-Aside.—On May 15, 1981, Lieutenant Colonel Anthony Andrews, TSARCOM's Deputy Director of Procurement and Production, wrote to Jesse Quigley, then the SBA's Deputy Associate Regional Administrator in New York, to renew the Army's request for the withdrawal of the set-aside of the engine contract. On June 8, 1981, Mr. Quigley responded with a request that the Army proceed to negotiation "at the earliest possible date." Three days later, the director of the Army's small business office, Juanita Watts, wrote to national SBA office in Washington, explaining that the Welbilt proposal was almost twice the fair market price (which has been reviewed and validated by Ms. Watts' office) and asking for the intervention of the national office in the withdrawal of the set-aside.[60]

At about the same time, Mr. Wallach began writing to Mr. Meese. Mr. Wallach's first memorandum to Mr. Meese, dated May 11, 1981, referred to an earlier trip to Washington during which

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[56] Testimony of Mr. Denlinger (Nofziger Trial) at 2006-07.

[57] Mr. Talenti told the Subcommittee staff that he met Congressman Mario Biaggi and SBA Deputy Associate Regional Administrator Jesse Quigley in the course of his visit.

[58] Testimony of Mr. Moreno (Nofziger Trial) at 1834-35.

[59] Testimony of Mr. Moreno (Nofziger Trial) at 1837-38.

[60] June 11, 1981 letter from Ms. Watts to Mr. Browne.

Mr. Wallach presented Welbilt's case to Mr. Meese [61] and suggested intervention by Secretary of Defense Caspar Weinberger or Secretary of the Army John Marsh.[62] On May 13, 1981, Mr. Wallach wrote to Mr. Meese that SBA Administrator Michael Cardenas intended to "cancel four programs, including this engine contract." In a memorandum dictated over the phone on May 19 for Mr. Meese and his assistant, Edwin Thomas, Mr. Wallach stated that the Army still planned to withdraw the contract; on the same day, he wrote a separate letter to Mr. Thomas in which he speculated that there was "a deliberate effort to deny this contract to Welbilt."

In testimony before the Subcommittee, Mr. Meese acknowledged that he asked his staff to "look into the matter and take whatever was the appropriate action, as we did in the dozens of those cases that used to come before us every year in the White House." [63] At the Nofziger trial, Mr. Meese clarified that some time in the Spring or Summer of 1981, he asked his deputy, Ed Thomas, to look into the matter.[64] White House documents indicate that Mr. Thomas delegated this matter to Kenneth Cribb, in the White House Office of Cabinet Affairs, with a May 22 note stating that Mr. Wallach was an extremely close friend of Mr. Meese.[65]

On June 18, 1981, Mr. Wallach wrote to Mr. Meese that:

> [SBA Administrator Michael] Cardenas is apparently once again about to accede to a request to cancel all outstanding bids on this engine project and throw it "open" . . . The problem now, as before, is to prevent a decision from being made which is irrevocable before all of the evidence is in.

The next day, on June 19, Robert Wright, then the SBA's Associate Administrator for Minority Small Business, wrote a letter to the Army, in which he concluded that negotiations were not possible and offered to withdraw the set-aside:

> Your letter of June 11, 1981, states that the fair market price has been reviewed by your office and such price has been validated. In view of this careful review and analysis by your office and program personnel at TSARCOM, we have no alternative but to conclude that we could not mutually agree upon such terms and conditions which would result in award of the contract.

Although Mr. Wright agreed to withdraw the set-aside of the engine contract, be conditioned the withdrawal upon the Army's agreement to reinstate the set-aside if competitive bidding did not result in a price within 10% of the Army's estimated "Fair Market Price." [66] Robert Turnbull, then an Associate Deputy Administrator of the SBA, reported this decision to Mr. Cribb, who then reported it to Mr. Thomas.[67]

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[61] The May 11 memorandum enclosed a letter of the same day from Mr. Wallach to Deputy White House Counsel Herbert Ellingwood in which Mr. Wallach noted that he had presented his concerns on Welbilt to Mr. Meese.

[62] The personal notebooks of David Epstein, then an assistant to Welbilt President John Mariotta, for May 13 state: "Marsh-Weinberger . . . White House—High Level . . . A lot of attention Meese/Stockman next to Reagan."

[63] Office of Government Ethics Review of the Attorney General's Financial Disclosure, Hearing Record at 29 (July 9, 1987).

[64] Testimony of Mr. Meese (Nofziger Trial) at 3214.

[65] May 22, 1981 memorandum from Mr. Thomas to Mr. Cribb.

[66] June 19, 1981 letter from Mr. Wright to Ms. Watts.

[67] June 19, 1981 letter from Mr. Turnbull, to Mr. Cribb; July 9, 1981 memorandum from Mr. Cribb to Mr. Thomas.

On June 29, 1981, Florence Randolph, an assistant to Mr. Meese, sent a memorandum to Mr. Meese in which she advised him of Mr. Wright's conditional agreement to withdraw the set-aside. Ms. Randolph went on to state that only intervention, if appropriate, from a high authority, could reverse the SBA's decision. If any action was to be taken, the memorandum concluded, it would have to be very rapid.

A week later, on July 6, Mr. Wallach wrote to Mr. Meese about the conditional withdrawal, noting that there now appeared to be "more urgency involved than I realized when we last spoke about this project." In this memorandum, Mr. Wallach alleged that the Army's estimate of a Fair Market Price "is largely drawn out of 'whole cloth' " and that the Army intended to steer the contract to a Texas company known as Garcia Ordnance Company. Mr. Wallach went on to state that the South Bronx would benefit greatly from an award to Welbilt and to again request direct intervention with the Secretary of the Army or the Secretary of Defense:

> My suggestions are as follows:
> 1. When we originally spoke, you thought it might be possible to arrange a meeting of the principals of Welbilt with either Secretary Marsh or Defense Secretary Weinberger (the comic book I left with you produced a meeting with Secretary Marsh and Secretary Weinberger). As I have indicated to you in the past, these men are very impressive. If that is not possible, may I suggest that at least the person assigned to inquire into this matter on behalf of your office interview them with a view towards getting a direct and firsthand recitation of their position as well as an opportunity to examine their plant. That may put things in a better perspective.
> 2. If it is possible to advise Mrs. Watts [of the Army] to defer action on the stipulation [to withdraw the contract from the 8(a) program] for a 30-day period of time or so, prior to the expiration of the contract provisions by law, that might serve in and of itself to readjust people's perspective concerning this contract.

A handwritten note obtained from White House files and dated July 13, 1981, indicates that Mr. Meese met with Mr. Cribb and asked him to deal with the engine contract. The note states:

> Re: Welbilt Electronics, Inc./Wallach. 13 Jul 1981—Disc w/Ken Cribb, Ken Cribb will stay on top of situation S: 13 Aug 81.[68]

In his testimony at the Nofziger trial, Mr. Meese stated that this was his note and that he had the conversation with Mr. Cribb. Mr. Meese explained that the date at the bottom of the note was a "suspense date", meaning that the matter should be brought up with him again at that time. Mr. Meese further testified that he believed Mr. Cribb had in fact "stayed on top of the situation"—although Mr. Cribb reported back to Mr. Meese only indirectly, through Mr. Thomas.[69] Mr. Thomas has told the Subcommittee staff that he does not remember any conversations with Mr. Meese about Welbilt and that he had "no dealings" with the company.

On July 16, Mr. Wallach wrote to Mr. Meese that "the options which could benefit Welbilt and which are outlined in my memo of July 6th" remained open, and further stated that the White House might prevail upon the Administrator of the SBA to delay any action adverse to Welbilt:

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[68] On July 6, 1981, Mr. Epstein's notebooks contain the cryptic statement: "Ed—Best person assigned to it—high priority."

[69] Testimony of Mr. Meese (Nofziger Trial) at 3214-16.

It may not be too late to contact Frank [sic] Cardenas, Director [sic] of the SBA. It is possible that he would be in a position to defer action as well, at least during an exploratory or investigatory period of time.

In the same memorandum, Mr. Wallach stated that Ms. Watts, the Army Small Business Director, had "passed the buck" and forwarded the SBA's conditional withdrawal of the set-aside to the Army legal department for review. Mr. Wallach's memorandum went on to state: "Whether this was as a result of intervention from your office or not, I do not know."

A week later, on July 21, David Epstein, an aide to Welbilt President John Mariotta who served as a liaison between Mr. Wallach and company officials in 1981, made the following entry in his daily diary:

Ed Thomas, Ed Meese's ass't, Wallach . . . Not dead yet . . . Ed M sez Watts buck-passing a result of White House inquiry.

Mr. Epstein told the Subcommittee staff that he assumed this information came from Mr. Wallach, although he did not specifically remember. Mr. Epstein stated that he also spoke directly to Mr. Thomas on occasion, at the direction of Mr. Wallach.

On July 20, the Army attempted to accept the SBA's offer to withdraw the set-aside without agreeing to the condition—to reinstate the set-aside if competitive bidding did not result in a price within 10% of the Army's estimated Fair Market Price—on the ground that acceptance of the condition would have violated Defense Department acquisition regulations.[70] The SBA, however, refused to approve the withdrawal of the set-aside on these terms and asked the Army to proceed to audit and negotiate. As Mr. Wallach explained in an August 3 memorandum to Mr. Meese:

I thought you would be interested in knowing that the SBA has reversed itself and refused to accede to the Army's request . . .

. . . [Welbilt has] received assurances from the SBA of a desire to aggressively pursue the obtaining of the contract by Welbilt.[71]

In an August 12, 1981 memorandum to Mr. Thomas, Mr. Cribb indicated that he had checked the facts in Mr. Wallach's memorandum with Robert Turnbull of the SBA. Mr. Cribb reported that while Mr. Wallach's memorandum contained "confusions," the SBA had not accepted the Army's position. He concluded that the SBA had made a good faith effort to achieve an equitable solution, but had run into a stone wall at the Army.[72] Mr. Epstein's diary for August 11, 1981 contains the following entry:

b.w.—Conduct up to now favorable result of WH intervention. Not surfacing. Will prevent Army from slipping by.[73]

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[70] July 20, 1981 letter from Ms. Watts to Mr. Quigley.

[71] In an August 8, 1981 memorandum to Mr. Wallach obtained from White House files, Mr. Epstein wrote that Mr. Wright would "correct the impression that he had 'agreed' to the withdrawal on any basis other than acceptance" of the SBA's condition.

[72] On September 2, Deputy Administrator Donald Templeman had called a meeting at the SBA "for review of the Welbilt situation . . . because of an informal White House request not further identified." September 2, 1981 memorandum from Messrs. Pineda and Reusche to file. On September 3, the SBA formally rejected the Army's request to withdraw the set-aside of the engine contract and asked for an audit of Welbilt's cost proposal and a pre-award survey of the company's facilities. September 3, 1981 letter from Mr. Wright to Ms. Watts.

[73] Mr. Epstein told the Subcommittee staff that he assumes this information came from Mr. Wallach, but he does not specifically recall.

Mr. Wallach stated in his interview that he could not recall that Mr. Meese had ever reported to him that he had taken any specific action on behalf of Welbilt.[74]

b. The Army's Decision to Audit.—In late Spring or early Summer 1981, Welbilt officials sought an audit of the company's proposal, apparently as a first step toward contract award. Mr. Wallach stated in his interview:

> I remember Welbilt saying, "All we want is an audit. We will pay for the audit ourselves. . . . The audit will demonstrate that our price structure [for the] engine is the correct one." [75]

The Army opposed Welbilt's request for an audit on the ground that the company's proposal was not even in the competitive range, so an audit would be a waste of time and effort.[76] Army officials pointed out that they were required to award 8(a) contracts at a "fair market price" based on "reasonable costs under normal competitive conditions" [77]; an audit would show only how much it would cost Welbilt to perform, not what reasonable competitive costs would be.[78]

On August 12, 1981, an Army memorandum indicates that Lieutenant Colonel O. Wayne Downhour of the Army Small and Disadvantaged Business Utilization office received a phone call from Jeff Noah, an aide to Congressman Robert Garcia, who asked why the Army was unwilling to audit Welbilt's proposal. In the course of this phone call, according to the memorandum, Lt. Col. Downhour overheard the following conversation between Mr. Noah and Stephen Denlinger of LAMA, who was in Mr. Noah's office at the time:

> DENLINGER. I am laying the groundwork at the White House and Congress and in 2 weeks I will have a very massive effort going.
>
> NOAH. I want to help any way I can. We will strategize later. What is the bottom line you want me to lay on this guy? [79]

Over the next two weeks, three Congressmen wrote to Secretary Marsh to request an audit of Welbilt's proposal.[80]

On August 17, White House aide Pier Talenti visited Welbilt at Mr. Denlinger's suggestion; according to Mr. Talenti, the message he got was " 'audit, audit, audit.' " On his return to Washington, Mr. Talenti told the Subcommittee staff, he contacted Army General Counsel Delbert Spurlock to push for an audit of Welbilt's pro-

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[74] Mr. Wallach stated that Mr. Meese could have said "I passed it along and let us see what happens," but that he did not remember. Transcript of June 29, 1987 interview of Mr. Wallach at 42–43.

[75] Transcript of June 29, 1987 interview of Mr. Wallach at 54.

[76] Testimony of Mr. Stohlman (Nofziger Trial) at 2776.

[77] 48 C.F.R. Section 19.806–1.

[78] May 24, 1987, interview of Mr. Stohlman; May 14, 1987 interview of Dr. Keenan; May 11, 1987 interviews of Mr. Murray and Mr. Beckham.

[79] August 13, 1981 memorandum for the file from Lt. Col. Downhour. Lt. Col. Downhour specifically remembered these comments in a May 4, 1987 interview with the Subcommittee staff.

[80] August 14, 1981 letter from Rep. Courter to Secretary Marsh; August 17, 1981 letter from Rep. Smith to Secretary Marsh; August 25, 1981 letter from Rep. Addabbo to Secretary Marsh.

posal.[81] That same day (August 28),[82] three Army officials—Juanita Watts, Robert Stohlman, and Colonel Albert Spaulding—went to the White House to meet with Mr. Talenti.[83] Mr. Talenti told these officials that he had been to the South Bronx, was impressed by Welbilt's facilities, and thought that they would be able to handle the contract.[84] According to Mr. Talenti, he went on to say: "These people are waiting for an audit. Give them an audit. Tell them if they are no good."

On September 4, 1981, Wayne Valis (of the White House Office of Public Liaison) wrote to Secretary of the Army John Marsh to request an audit of Welbilt's proposal.[85] Mr. Valis' memorandum explained that LAMA had been helpful in supporting Administration initiatives, and it appeared that Welbilt came "very close to what the President has espoused for minority enterprise." [86] In an interview with the Subcommittee staff, Mr. Valis stated that this letter was prepared by LAMA, and that he made no attempt to verify the truth of the statements about Welbilt.[87] He pointed out, however, that because the White House Counsel's office had advised White House staffers not to intervene in specific procurements, he sent his memorandum through the White House military aide's office.

According to Mr. Valis, he learned of the prohibition on involvement in specific procurements through discussions with the White House Counsel's office and possibly from a memorandum prohibiting any direct contact with DOD on these issues. Mr. Valis stated that other lobbyists had asked him to get involved in procurements on a number of occasions, and he would "just tell them that they didn't like us getting involved in procurements."

Former Counsel to the President Fred Fielding told the Subcommittee staff that he did circulate a memorandum in mid-1981, cautioning White House staff members to limit contacts with procurment officials. This memorandum was later incorporated into a formal written White House policy on procurement matters, in effect since October 1981, which states:

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[81] Mr. Stohlman, an official in the Assistant Secretary's office, told the Subcommittee staff that the call came in from Mr. Talenti in the morning and he went over to the White House the same afternoon. Mr. Spurlock told the Subcommittee staff that he does not remember speaking to Mr. Talenti until February or March 1982. However, Mr. Spurlock acknowledged that his secretary had taken numerous phone messages from Mr. Talenti in the fall and winter of 1981. This was confirmed by Mr. Spurlock's former Secretary, Linda Christensen, who told the Subcommittee staff that she remembered several messages with the notation "please call back"—but did not know whether Mr. Spurlock had in fact returned Mr. Talenti's calls.

[82] Testimony of Mr. Stohlman (Nofziger Trial) at 2774.

[83] Testimony of Mr. Stohlman (Nofziger Trial) at 2777. This meeting was held in Mr. Nofziger's office in the Old Executive Office Building. May 22, 1987 interview of Mr. Talenti. In interviews with the subcommittee staff, both Mr. Stohlman and Col. Spaulding remembered a tour of the office; Col. Spaulding remembered a specific reference to Mr. Nofzinger, but Mr. Stohlman did not. May 24, 1987 interview of Mr. Stohlman; May 7, 1987 interview of Col. Spaulding.

[84] Testimony of Mr. Stohlman (Nofziger Trial) at 2780–81; May 24, 1987 interview of Mr. Stohlman; May 7, interview of Col. Spaulding; May 22, 1987 interview of Mr. Talenti.

[85] Secretary Marsh and Mr. Valis have indicated to the Subcommittee staff that they were acquaintances because they had served on the White House staff together under President Ford.

[86] Secretary Marsh told the Subcommittee staff that he was out of the country at the time his office received this memorandum. Secretary Marsh stated that he personally reviewed the memorandum, but does not believe it had any impact, as a decision to audit Welbilt's proposal had already been made.

[87] See Testimony of Mr. Denlinger (Nofziger Trial) at 2122. Mr. Valis stated that he added qualifications to the letter, such as "I have been told" and "Please give this the appropriate consideration."

Procurement Agencies.—In recent years, the public has become increasingly sensitive to the allegations of improper influence in the awarding of government contracts. Obviously, no member of the White House staff should contact any procurement officer about a contract in which he has a personal financial interest or in which a relative, friend, or business associate has a financial interest. This is true not only as to calls or contacts in which influence is directly exerted, but also as to so-called "status" calls or other communications which might direct the attention of the procurement officer to the fact that the White House staff member has an interest.

There are likely to be occasions when the White House has a legitimate interest in information about procurement matters; in such instances, the communication should be made by persons who have no direct interest themselves, and whose friends or associates have no such interests. It is advisable that the lack of such interest be made known to those receiving the communication so that unintended inferences do not arise. To the extent that it can be done, information should be obtained after the contracting procedure is completed, or from persons not involved in the decision-making process. To avoid the appearance of conflict and subsequent embarrassment, White House staff members who feel they must contact procurement agencies with regard to pending matters should also first contract the Office of the Counsel to the President.[88]

On September 8, 1981, the Army agreed to audit Welbilt's proposal.[89] In an interview with the Subcommittee staff, Robert Stohlman—an aide to Assistant Secretary of the Army J.R. Sculley—stated that the decision to audit was a direct result of pressure from the White House and Members of Congress: "We were getting hit over the head and shoulders by the SBA, the Small Business Committees and White House staffers who were all pushing the audit." Mr. Stohlman repeated this point at the Nofziger trial, testifying that the Army agreed to audit Welbilt's proposal within a week of his meeting with Mr. Talenti because of "[t]he interest of Mr. Talenti and the interest also of all of the members of Congress." [90] TSARCOM officials have told the Subcommittee staff that they agreed to audit Welbilt's proposal only because they were directed to do so by the Assistant Secretary's office.[91]

c. The Results of the Audit.—Before Welbilt's proposal was audited, the Defense Logistics Agency (DLA) conducted a pre-award survey of Welbilt's facilities. On October 1, 2, and 5, 1981, a DLA engineer visited Welbilt, met with numerous Welbilt and Avco employees, and concluded that, with Avco's assistance, Welbilt had the technical ability to perform the contract.[92] TSARCOM officials say that they were skeptical of DLA's findings and sent their own team up to Welbilt to review the company's facilities.[93] The two TSARCOM officials who conducted this site visit—senior project engineer Gene Austin and technician Paul Sandhu—told the Subcommittee staff that Welbilt had hired at least one engineer who could provide satisfactory answers to their questions about how the engines would be built, but had no building or equipment in place. They concluded that Welbilt would likely have difficulty getting started, but would ultimately be able to produce the engines.

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[88] The White House Counsel's office provided the Subcommittee with a copy of this policy by letter dated December 7, 1987.

[89] September 8, 1981 memorandum from Col. Andrews to Mr. Liebman.

[90] Testimony of Mr. Stohlman (Nofziger Trial) at 2783.

[91] May 14, 1987 interview of Dr. Keenan; May 11, 1987 interviews of Mr. Murray and Mr. Beckham.

[92] October 5, 1981 DLA Inter-Office Memorandum from Mr. Troast and Mr. Raps.

[93] May 14, 1987 interview of Dr. Keenan; May 11, 1987 interview of Mr. Sandhu; June 3, 1987 interview of Mr. Austin.

On November 27, 1981, the Defense Contract Audit Agency (DCAA) completed its audit of Welbilt's proposal. DCAA was unable to reach a definitive conclusion as to Welbilt's ability to perform the contract for the cost Welbilt proposed because (a) it had not received a technical evaluation of the proposal; (b) Welbilt had not prepared budgets for the performance period, against which its proposed costs could be judged; and (c) the cost or pricing data supplied by Welbilt to support its proposal was not complete. With these qualifications, the DCAA reviewed Welbilt's proposal and questioned the validity of $6,198,776 of Welbilt's proposed $38,929,875 price.[94]

Welbilt officials and consultants took this audit report as proof that $33 million (Welbilt's $39 million proposal less the $6 million in challenged costs) was the "fair market price" for the contract.[95] Several TSARCOM officials have told the Subcommittee staff that the audit report did not prove that Welbilt's costs were reasonable, only that they were real costs. According to these officials, an audit shows only whether a company's proposed costs are allocable and allowable (*i.e.*, that "a company can spend money"); it does not show what the "fair and reasonable" price would be—this must be determined on the basis of market conditions and the price that other companies would charge.[96]

At the same time, the Army took steps to re-validate its estimate of the fair market price (FMP) for the contract. In part, this effort arose out of a belief that the Army's estimate should be revised upward to account for the lapse of time and additional inflation.[97] In addition, the Army's estimate had come under attack by Welbilt and the SBA on the ground that the Army had calculated the FMP on the basis of the price charged by the previous bidder—Chrysler—without accounting for $11 million of equipment that Welbilt alleged had been furnished to Chrysler by the government at no cost.[98] Because of the high visibility of the contract, the Army wanted to be certain of its estimate.[99]

On December 4, 1981, after reviews by the TSARCOM comptroller,[100] the Army small business office,[101] and the Comptroller of the Army,[102] the Army adjusted its FMP estimate up from $19.4

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[94] November 27, 1981 Audit Report on Evaluation of FFP Proposal DAAJ09-81-P-0022 Submitted by Welbilt Electronic Die Corp.

[95] January 20, 1982 unsigned Welbilt memorandum entitled "Military Standard Engine"; February 5, 1982 letter from Mr. Denlinger to Mr. Spurlock; Testimony of Mr. Denlinger (Nofziger Trial) at 2012; Transcript of June 29, 1987 interview of Mr. Wallach at 55.

[96] May 11, 1987 interviews of Mr. Murray and Mr. Beckham; May 20, 1987 interview of Mr. Dausman; May 14, 1987 interview of Dr. Keenan. One TSARCOM memorandum attributed Welbilt's higher price to the fact that Welbilt planned to manufacture only four parts of the 308 parts to this engine, compared to the 60% in-house production expected of a firm in the competitive market manufacturing engines. March 4, 1982 memorandum from Lt. Col. Bowersox to the Assistant Secretary's Office.

[97] Unsigned handwritten notes of September 9, 1981 meeting of Messrs. Stohlman and Dausman, Dr. Keenan, Ms. Watts, and Col. Spaulding.

[98] *E.g.*, May 1, 1981 letter from Mr. Quigley to Lt. Col. Andrews; June 8, 1981 letter from Mr. Quigley to Lt. Col. Andrews.

[99] As one former TSARCOM procurement official explained to the Subcommittee staff, "in the political arena, you don't want to go to the highest levels of the government and find out that you're all wet." May 6, 1987 interview of Lt. Col. Andrews.

[100] September 14, 1981 TSARCOM "Point Paper."

[101] September 11, 1981 memorandum from Col. Downhour to Ms. Watts.

[102] November 25, 1981 TSARCOM "Point Paper."

million to $23.7 million. This increase in the Army's estimate was the result of increased inflation due to the delay in the award and of the use of a different Producer Price Index by the Comptroller of the Army.[103] The Army did not make any adjustment to compensate for the facilities that Welbilt alleged had been provided to Chrysler because, according to the Army, (a) most of these facilities had in fact never been provided to Chrysler; (b) the actual value of equipment provided to Chrysler for eight years of production was only $1 million; and (c) all existing government equipment for the production of military standard engines had been promised to Welbilt as well.[104]

Welbilt officials took the increase in the Army's FMP estimate as a vindication and as the first step toward a negotiated agreement with the Army.[105] TSARCOM officials, on the other hand, did not see the narrowing of the price gap as significant: even if Welbilt accepted the results of the DCAA audit, its price would still be a full $10 million higher than what TSARCOM officials saw as the highest price the Army could possibly accept.[106]

SBA, Army and Welbilt officials met to discuss the engine contract on January 15, 1982, in the Administrator's conference room at the SBA. Donald Templeman, who attended as Deputy Administrator of the SBA, testified at the Nofziger trial that the basic purpose of the meeting, in his view, was for the Army to explain its decision not to accept Welbilt's proposal.[107] Mr. Templeman testified that he and other SBA officials were also skeptical of the merits of Welbilt's proposal at that time "[b]ecause of the difference in price, some several million dollars, because the contractor had not manufactured engines before and because this was a one-time procurement where there wouldn't be any follow-on of the same kind of engine." [108]

The January 15 meeting was also attended by White House aides Pier Talenti and Henry Zuniga.[109] Mr. Talenti and Mr. Zuniga each told the Subcommittee staff that they spoke up on behalf of Welbilt at the January 15 meeting. According to Mr. Talenti, he and Mr. Zuniga told the Army: "Give them a fair chance. Tell them that they are no good. Tell them that SBA can cover the difference in price. But tell them something. This thing was almost one year old." [110] Mr. Zuniga stated that he could not remember

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[103] December 4, 1981 memorandum from Lt. Col. Thompson to Dr. Sculley; December 21, 1981 TSARCOM memorandum explaining difference in FMP estimates.

[104] March 4, 1982 memorandum from Lt. Col. Bowersox to the Assistant Secretary's office; March 25, 1982 memorandum for the record from Mr. Beaumont; April 15, 1982 letter from Mr. Spurlock to Mr. Denlinger.

[105] January 19, 1982 letter from Mr. Mariotta to Mr. Wright; unsigned January 20, 1982 Welbilt memorandum entitled "Military Standard Engine."

[106] January 7, 1982 telex from DARCOM to the Assistant Secretary's office. Dr. Keenan characterized the Army's FMP estimates as "on the very high side of reasonable" and stated that he was convinced that competitive bidding would have resulted in a price of less than $19 million even in 1982. May 14, 1982 interview of Dr. Keenan.

[107] Testimony of Mr. Templeman (Nofziger Trial) at 2703–04.

[108] Hearing Record, Part 1 at 24; Testimony of Mr. Templeman (Nofziger Trial) at 2700, 2704–05.

[109] Attendance list for January 15, 1982 meeting re: Welbilt Elec. Die Corp. A January 12, 1982 SBA memorandum signed by Mr. Quigley indicates that the meeting "was arranged through the influence of the White House."

[110] A memorandum from Mr. Wallach to Mr. Meese several days after the meeting quotes Mr. Talenti as stating that "this was 'Lyn's last week and it would be nice if he could go out with a

Continued

specifically what he said, but that he is "not a guy who sits down and just listens. We were definitely advocating for Wedtech, we being Talenti and myself." [111]

Deputy Assistant Secretary of the Army George Dausman told the Subcommittee staff that he attended the meeting to make a presentation on how the Army had reached its new Fair Market Price (FMP) estimate. According to Mr. Dausman, the Army's position at the meeting was that this new price was not negotiable. Mr. Dausman's assistant, Mr. Stohlman, stated that as a result of the meeting, the Army finally believed it had communicated to the SBA that it was serious about its price estimates and "was not going to budge." [112] This was confirmed by Mr. Templeman in his testimony at the Nofziger trial.[113]

3. THE AWARD TO WEDTECH

a. The Second Attempt to Withdraw the Set-Aside.—On January 16, 1982—one day after the meeting between the Army and the SBA—Army Small Business Director Juanita Watts formally requested that the SBA either close the $10–15 million price gap out of its own business development (BDE) funds or accept the withdrawal of the 8(a) set-aside. Within ten days of this letter, Senator D'Amato wrote to then-SBA Administrator Michael Cardenas and Secretary of the Army John Marsh to ask that the Army's request to release the engine contract from the 8(a) program be denied or withdrawn and the contract be awarded to Welbilt.[114] Congressman Joseph Addabbo, then the chairman of the Defense Subcommittee of the House Appropriations Committee, made a similar request.[115]

On January 19, 1982, Welbilt President John Mariotta wrote to SBA Associate Administrator Robert Wright, stating that Welbilt was prepared to negotiate with the Army. The same day, Mr. Wallach wrote a memorandum to Mr. Meese, in which he speculated that the Army could be pressured into contracting with Welbilt:

> My only thought is that the Army can be pressured into making the bid available to Welbilt and if Welbilt accepts it will be impossible for them to back away from the agreement. We'll just have to leave it up to Welbilt to see whether or not they can economically survive such [a] contract. I presume they know what they are doing.[116]

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bang and get this contract.' " January 19, 1982 memorandum from Mr. Wallach to Mr. Meese. Mr. Wallach told the Subcommittee staff that he was told of this statement by Welbilt officials. Transcript of June 29, 1987 interview of Mr. Wallach at 48.

[111] Col. Spaulding, who attended the meeting for the Army, told the Subcommittee staff that Mr. Zuniga gave the impression that the White House supported an award to Welbilt, but was very careful to avoid saying this outright.

[112] May 24, 1987 interview of Mr. Stohlman.

[113] Testimony of Mr. Templeman (Nofziger Trial) at 2704–05. Mr. Moreno testified that Wedtech officials were discouraged about their prospects for getting the engine contract—although an invitation to Mr. Mariotta to attend a White House conference with the President the next week remained a bright spot. Testimony of Mr. Moreno (Nofziger Trial) at 1840.

[114] January 20, 1982 letter from Senator D'Amato to Mr. Cardenas; January 25, 1982 letter from Senator D'Amato to Secretary Marsh.

[115] January 25, 1982 memorandum from Ms. Watts to Mr. Spurlock (reflecting January 22 telephone call from Neil Kornblatt, an aide to Congressman Addabbo); March 7, 1988 interview of Secretary Marsh (reporting telephone calls from Rep. Addabbo in this period); Testimony of Mr. Stohlman (Nofziger Trial) at 2832 (quoting Grand Jury testimony in which Mr. Stohlman stated that Rep. Addabbo placed a "hold" on the contract).

[116] In December 30, 1981 memorandum, Mr. Wallach provided Mr. Meese with the address and phone number of the General Donald R. Keith, commanding general of the Army Materiel Command.

Two days later, Mr. Wallach wrote another memorandum to Mr. Meese, in which he stated that Mr. Cardenas was the "key figure" in Welbilt's efforts to get the engine contract:

> Apparently the key figure at this particular moment is Frank [sic] Cardenas, the Director [sic] of the SBA. . . . If he refuses to "return" the contract to the U.S. Army for these engines, the Army will have no alternative but to offer the contract to Welbilt. . . . If my information is correct, this may be the last step and Cardenas is the key figure. Once the Army enters into negotiations with Welbilt a contract will result.

Mr. Cardenas and his top aide, David Gonzales, told the Subcommittee staff that, after the January 15 meeting, they decided not to sign off on the Welbilt contract until the Army was satisfied with the terms and conditions. Mr. Cardenas' Deputy Administrator, Donald Templeman testified at a Subcommittee hearing that "the Administrator, Mr. Cardenas, properly took the position that the SBA would not try and force the Army into a contract with Welbilt unless the Army could negotiate a price it found acceptable." [117]

On February 5, 1982, Mr. Cardenas was dismissed as Administrator of the Small Business Administration and Mr. Templeman became Acting Administrator.[118] On February 18, Mr. Wallach wrote to Mr. Templeman to inform him of Welbilt's interest in the engine contract, which he characterized as "a matter of true urgency." Mr. Wallach's letter explained:

> For well over a year, contract negotiations between Welbilt and the U.S. Army have transpired. They reached a point where action by SBA Administrator Cardinez [sic] was required in order to permit final price negotiations to commence. . . .
>
> This material is directed to you following a brief conversation I had with [Administrator designate] Jim Sanders. I was unaware of the fact that he had not as yet been confirmed and he suggested this course of action.

Mr. Templeman and Mr. Sanders both testified before the Subcommittee that they do not recall being contacted by Mr. Wallach in early 1982 and did not even know who Mr. Wallach was at the time.[119]

By mid-February, the Army had decided not to change its position despite the inquiries from Senator D'Amato and Congressman Addabbo.[120] At this point, Welbilt officials decided that they needed to bring in "more powerful" consultants to break the stalemate with the Army and get the contract.[121] At the suggestion of LAMA President Stephen Denlinger, Welbilt agreed to contact the new public relations firm formed by Mr. Nofziger—who had just left his position at the White House—and his partner, Mark Bragg.[122] In late February and early March, Mr. Denlinger met

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[117] Hearing Record, Part 1 at 24.

[118] Mr. Templeman told the Subcommittee staff that the Welbilt matter "might have hastened" Mr. Cardenas' departure from the agency. However, Mr. Templeman stated that there were strong management reasons for Mr. Cardenas' dismissal. June 9, 1987 interview of Mr. Templeman; June 23, 1987 interview of Mr. Templeman. The Subcommittee has found no independent evidence that Mr. Cardenas' dismissal was related to Welbilt.

[119] Hearing Record, Part 1 at 26–27 (Testimony of Mr. Templeman); *id.* at 135–36 (Testimony of Mr. Sanders).

[120] February 18, 1982 letter from Secretary Marsh to Senator D'Amato; March 7, 1988 interview of Secretary Marsh (stating that he did not change his position in response to inquiries from Senator D'Amato and Rep. Addabbo).

[121] Testimony of Mr. Moreno (Nofziger Trial) at 1843.

[122] Testimony of Mr. Moreno (Nofziger Trial) at 1843; Testimony of Mr. Denlinger (Nofziger Trial) at 2022. Pier Talenti—an unpaid aide to Mr. Nofziger at the White House who had assisted Welbilt in its efforts to get the engine contract—appears to have suggested to Mr. Denlinger that Welbilt hire Nofziger & Bragg. *Id.* at 2014–2019.

first with Mr. Nofziger and then with Mr. Bragg to ask their assistance in building LAMA's contacts at the White House, and in getting the engine contract for Welbilt.[123] According to Mr. Denlinger, Mr. Bragg stated that the firm would make the contacts necessary to ensure that Welbilt would get the engine contract.[124]

Also in February, Mr. Denlinger wrote a nine-page letter to Army General Counsel Delbert Spurlock, in which he laid out Welbilt's pricing arguments and requested that the Army begin negotiations with the company immediately.[125] Shortly after Mr. Spurlock received this letter, Mr. Bragg asked to meet with him to discuss Welbilt and the Army engine contract.[126] Mr. Spurlock told the Subcommittee staff that Mr. Bragg stated that it was in the Administration's interest to support small business and to deal with the President's campaign promise to bring business to the South Bronx. Over the next two months, according to Mr. Spurlock, he discussed Welbilt and the engine contract in three or four phone calls with Mr. Bragg, and he actually made two visits to Mr. Bragg's office.[127]

On March 19, 1982, the SBA formally rejected the Army's request that it offset the $10–$15 million price difference between the Army's fair market price and Welbilt's cost proposal. As the SBA letter explained:

> We want to respond to requests of this kind as affirmatively as we can, but we are required to manage our limited BDE [Business Development Expense grant] funds as prudently as possible. Average BDE grants to our 2,200 socially and economically disadvantaged firms come to about $100,000. For us to make a mult-million dollar BDE grant to a single firm would, we believe, raise questions about our management of the 8(a) program as a whole. Accordingly, we decline your request.

Rather than withdraw the contract from the 8(a) program, however, the SBA requested that the Army "proceed to negotiate with Welbilt" and stated that it would consider a lesser, "reasonable" amount of BDE money.[128]

On March 29, 1982, Mr. Spurlock told the Subcommittee staff, he went to the White House to meet with Mr. Talenti. Mr. Spurlock stated that he saw Mr. Talenti as a "little guy sitting at a desk" who "didn't add anything" of substance to what Mr. Spurlock already knew about Welbilt and the engine contract.[129] That same

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[123] Testimony of Mr. Denlinger (Nofziger Trial) at 2020–2022, 2025, 2039. Mr. Denlinger testified that Mr. Nofziger did not indicate any prior awareness of Welbilt or the engine contract. *Id.* at 2124.

[124] Testimony of Mr. Denlinger (Nofziger Trial) at 2022, 2039, 2042–43. Mr. Denlinger testified that while LAMA was nominally the client, it was agreed that Welbilt would pay a substantial portion of the fees directly to Nofziger & Bragg. *Id.* at 2024–25, 2126; *see* Testimony of Mr. Moreno (Nofziger Trial) at 1755–57.

[125] February 5, 1982 letter from Mr. Denlinger to Mr. Spurlock. Mr. Spurlock told the Subcommittee staff that he also received a telephone call from Mr. Denlinger in early 1982. March 7, 1988 interview of Mr. Spurlock.

[126] Mr. Spurlock also told the Subcommittee staff that he corresponded with Mr. Nofziger beginning in 1977 and got his job at the Army with Mr. Nofziger's assistance.

[127] Mr. Spurlock stated that Mr. Bragg provided him information about TSARCOM's treatment of the engine contract and the letter from Mr. Denlinger. *See* Testimony of Mr. Denlinger (Nofziger Trial) at 2056 (Mr. Bragg reported occasional conversations with Mr. Spurlock to Mr. Denlinger).

[128] March 19, 1982 letter from Mr. Templeman to Ms. Watts. This letter was signed by Mr. Turnbull on behalf of Mr. Templeman; Mr. Templeman has testified that he participated in the formulation of the SBA position on this issue, but does not specifically remember the letter. Testimony of Mr. Templeman (Nofziger Trial) at 2711; *see* Hearing Record, Part 1 at 28–29.

[129] Mr. Talenti's calendar indicates that March 29 was his last day at the White House.

day, Mr. Spurlock sent a memorandum to Secretary Marsh, in which he stated that Mr. Nofziger would be calling later in the day to "indicate the presence of White House interest" in Welbilt and the South Bronx:

> It is likely that you will be getting a call from Lyn Nofziger on the Welbilt matter today. He will indicate the presence of White House interest in contracting in the South Bronx where Welbilt is located. I have indicated to his associate and to Mr. Talenti at the White House that $24 million is about as much as the Army technical people would justify in awarding the Welbilt contract. Even this amount is apparently very high in [Undersecretary of the Army] Jim Ambrose's estimation.

Records from Secretary Marsh's office indicate that Mr. Nofziger called on March 29, 1982, and that the Secretary returned this call.[130] Mr. Marsh told the Subcommittee staff that Mr. Nofziger's call was "not an arm-twisting type of call", and that Mr. Nofziger was simply "letting us know he was interested" in Welbilt and the engine contract. Mr. Marsh stated that he did not make any promises to Mr. Nofziger.

Later that same day, Secretary Marsh called a meeting of top Army officials to discuss the engine contract.[131] Assistant Secretary J.R. Sculley testified at the Nofziger trial that he attended this meeting, along with Deputy Under Secretary John Shannon, Army small business director Juanita Watts, and Mr. Spurlock. According to Dr. Sculley, the officials present reaffirmed the Army's position of asking for withdrawal of the engine contract from the 8(a) program.[132] A memorandum from Dr. Sculley to Under Secretary of the Army James Ambrose two days after the March 29 meeting supports this testimony, stating that: "The difference between the Welbilt proposal and what [the Army] expects to result from a competitive procurement is too great for reasonable negotiations."

On April 16, Secretary Marsh met again with top Army officials to discuss the contract.[133] A point paper prepared for the meeting states that the Army was ready to make a decision to withdraw the contract from the 8(a) program and go competitive:

> *Current Status:*
> 1. All known issues have been addressed.
> 2. Correspondence has been prepared and coordinated with which to respond to all open inquiries.
> 3. No basis has been found on which to pursue the SBA/Welbilt proposal.
> *Recommendations:*
> 1. Make final Army decision to deny 8(a) request (Action—Sec Army).
> 2. Sign and dispatch replies to open inquiries: LAMA (Action—Mr. Spurlock), Senator Kasten (Action—Sec Army), House Small Business Committee Staffer (Action—Mrs. Watts).
> 3. Notify SBA of decision (Action—Mrs. Watts).
> 4. Authorize [the responsible Army command] to release an unrestricted RFP for current MSE requirements (Action—Dr. Sculley).[134]

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[130] March 29, 1982 telphone message from Mr. Nofziger. The Army General Counsel's office has informed the Subcommittee staff that the check mark on this phone message indicates that the call was returned.

[131] Testimony of Dr. Sculley (Nofziger Trial) at 2871. Dr. Sculley's calendar for March 29 indicates a 4:00 meeting with Secretary Marsh at Mr. Marsh's request.

[132] Testimony of Dr. Sculley (Nofziger Trial) at 2881.

[133] Testimony of Dr. Sculley (Nofziger Trial) at 2886–87. Dr. Sculley indicated that this meeting was attended by Secretary Marsh, Mr. Ambrose, Dr. Sculley, Mr. Spurlock, Mr. Shannon, and Ms. Watts.

[134] Robert Stohlman, an official in Dr. Sculley's office, testified that he prepared this memorandum. Testimony of Mr. Stohlman (Nofziger Trial) at 2803, 2808–09. Dr. Sculley testified that

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Dr. Sculley testified that the April 16 meeting resulted in a consensus that the contract should not be awarded to Welbilt and a final decision by the Secretary of the Army to withdraw the contract from the 8(a) program.[135] Over the next week, SBA Administrator James Sanders, Congressman Addabbo and Senator D'Amato, and Mr. Denlinger were all informed of the Army's decision to go competitive.[136] As Mr. Spurlock's letter to Mr. Denlinger concluded:

> . . . [T]he Department of the Army has given the SBA/Welbilt proposal thorough and fair consideration. Considering the extended period of time that this pilot program reservation has been under review, and the extensive and high level of review it has received, we believe that a decision to procure the military standard engines under a competitive process would be fully justified and in the best interest of the government.

Mr. Denlinger testified at the Nofziger trial that he was "very dejected by this response." [137] According to Mr. Denlinger, he immediately contacted Mr. Bragg about the letter, and Mr. Bragg told him not to worry about it:

> He indicated that I really didn't have to worry too much about the content of the letter, that that was more or less a pro forma, that other things were happening that I didn't know about that were maybe a little more optimistic.[138]

Despite the Army's April 16 decision to withdraw the engine contract from the 8(a) program, TSARCOM was never given a green light to issue a competitive solicitation. On April 30, TSARCOM sent a telex to the Pentagon, stating that the procurement was still urgent. On May 3, this telex came to the attention of Under Secretary Ambrose, who attended the April 16 meeting. Mr. Ambrose wrote a note to his staff on the telex indicating his puzzlement at the continued problem: "I thought this was settled. What happened?" Two weeks later, Mr. Ambrose received the following reply:

> a. Following the 16 April 1982 meeting with the [Secretary of the Army], letters stating the [Army] position were sent to SBA, Senate Small Business Committee and LAMA. Release of the competitive solicitation was to be delayed for a suitable "short period."
>
> b. Mr. Spurlock continues to place a hold on the release of the competitive solicitation.[139]

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the statements in the memorandum accurately reflect the status of the engine contract within the Army as of April 16. Testimony of Dr. Sculley (Nofziger Trial) at 2888–91.

[135] Testimony of Dr. Sculley (Nofziger Trial) at 2891–92, 2943. Mr. Spurlock, who sent a letter to Mr. Denlinger immediately after the meeting stating that the Army would withdraw the contract from the 8(a) program, told the Subcommittee staff that he did not think any decision was reached. March 7, 1988 interview of Mr. Spurlock.

[136] April 16, 1982 letter from Ms. Watts to Mr. Sanders; April 16, 1982 letter from Ms. Watts to Mr. Kornblatt; April 15, 1982 letter from Mr. Spurlock to Mr. Denlinger (the Army General Counsel's office has informed the Subcommittee staff that this letter, although dated April 15, was sent out on April 16); April 20, 1982 memorandum from Mr. Shannon to Army officials reporting conversation with Senator Kasten's staff. *See* Testimony of Dr. Sculley (Nofziger Trial) at 2888–91.

[137] Testimony of Mr. Denlinger (Nofziger Trial) at 2054.

[138] Testimony of Mr. Denlinger (Nofziger Trial) at 2055.

[139] May 17, 1982 memorandum from Col. Yarborough to Col. Brownlee. Mr. Stohlman told the Subcommittee staff that he prepared this memorandum on the basis of conversations with Alex Parrish in Mr. Spurlock's office. According to Mr. Stohlman, he spoke to Mr. Parrish on several occasions to ask whether the solicitation could be released; on each occasion, Mr. Parrish would go talk to Mr. Spurlock, then come back and say "hold it for a while longer." May 24, 1987 interview of Mr. Stohlman.

In an interview with the Subcommittee staff, Mr. Spurlock denied that he had placed a "hold" on the release of a competitive solicitation.[140]

b. The White House Involvement.—On April 8, 1982, Mr. Nofziger wrote to Mr. Meese to request his assistance in getting the engine contract for Welbilt. Mr. Nofziger's memorandum read as follows:

When I saw you on Monday, April 5, we discussed briefly the Welbilt Company's efforts to bring industry to the South Bronx through the medium of an Army contract to manufacture small engines.

Welbilt appears to be well qualified to do the work, but it is having some problems with the Army which wants to go back to the old supplier, even though awarding the contract to Welbilt would be a major first step in the President's commitment to revitalize the South Bronx.

I may have misspoken when I said I thought Carlucci would make the decision; it being an Army contract, I suppose Jack Marsh would have the final word, but at the same time, I am sure he would listen carefully to Carlucci or Weinberger or Meese or even Reagan.

Ed, I really think it would be a blunder not to award that contract to Welbilt. The symbolism either way is very great here.

cc: Jim Jenkins.

Jim, please see that Ed sees this. Thanks.

A tracking sheet attached to the memorandum indicates the White House staff to whom this letter was referred. Mr. Meese testified at the trial of Mr. Nofziger as to what the notations on the tracking sheet mean.

Mr. MEESE. It is noted here that Mr. Hammerstrom who worked in my office was involved in seeing the document, that Mr. Cribb who as of this date was a member of my office, saw it and was given the action on it and that a copy was sent to me for information and it was subsequently sent to Mr. Jenkins for action.

Mr. MCKAY. Does that indicate that the April 8, 1982, memorandum was subsequently sent to Mr. Jenkins for action?

Mr. MEESE. Yes, it does.[141]

Mr. Jenkins' testimony at the Nofziger trial on the tracking memo was as follows:

Mr. MCKAY. Looking at the tracking sheet and taking into account the practice of your office and the fact that this memorandum was prepared by Mr. Nofziger, can you state whether or not on the basis of the information on the tracking sheet this memorandum was received by Mr. Meese?

Mr. JENKINS. In effect, the tracking sheet tells Mr. Cribb, he is Mr. Meese's administrative assistant, that this is—that it is his responsibility to see that Mr. Meese got it.

Mr. MCKAY. What does that tell you knowing the practices of the office?

Mr. JENKINS. He got it. Mr. Cribb always does that.[142]

A handwritten notation on the upper left-hand corner of the memorandum, addressed to Mr. Jenkins, states:

JJ—Our Wellbilt [sic] file is missing (even those under possible other headings!) I seem to remember everything being pulled together for a meeting in Dec.-Jan. EM may have at home (we will continue to look) MFS.

Mr. Meese testified at the Nofziger trial that he had no independent recollection of the earlier conversation reflected in the memorandum from Mr. Nofziger and does not believe he gave any instructions to anybody to follow up on the letter.[143] Mr. Meese

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[140] Mr. Spurlock stated that he was out of the office on travel at the time and his aide was probably unwilling to sign off on the release of the competitive solicitation in his absence. However, Army records reflect only one day of travel by Mr. Spurlock between April 24 and May 18.

[141] Testimony of Mr. Meese (Nofziger Trial) at 3218.

[142] Testimony of Mr. Jenkins (Nofziger Trial) at 2319.

[143] Testimony of Mr. Meese (Nofziger Trial) at 3219–22, 3291.

testified that Mr. Nofziger was his personal friend of ten to fifteen years.[144] Mr. Meese further testified that he is sure he discussed Welbilt with Mr. Jenkins, but has no specific recollection of what they may have discussed.[145] He stated that he probably did not specifically assign Mr. Jenkins any duties related to Welbilt [146] and does not recall giving Mr. Jenkins the go-ahead to get involved, although he concurred that the documents indicate he may have.[147] At a Subcommittee hearing in July 1987, Mr. Meese testified that he might have asked Mr. Jenkins to look into the matter and take whatever action was appropriate.[148]

Mr. Jenkins testified that he has no independent recollection of having seen Mr. Nofziger's letter.[149] Mr. Jenkins stated that he first heard of Welbilt in mid-April, when Mr. Bragg brought Mr. Denlinger into his office to discuss the engine contract.[150] Mr. Jenkins testified that he was "delighted" at the opportunity to assist a disadvantaged business [151]—particularly given Welbilt's location in the South Bronx [152]—and told Messrs. Bragg and Denlinger that he would look into the matter and try to assist them.[153] Within a day or two after this meeting, Mr. Jenkins testified, he informed Mr. Meese of his intent to assist Welbilt in its efforts to get the engine contract and Mr. Meese approved.[154]

On April 16, 1982, Mr. Jenkins wrote a memorandum to Cabinet Secretary Craig Fuller, in which he reported Mr. Nofziger's request to Mr. Meese that the White House intervene in the engine contract on behalf of Welbilt and sought Mr. Fuller's guidance on the matter. In this memorandum, Mr. Jenkins questioned whether the White House should take any action at all on behalf of Welbilt.

> Lyn Nofsiger [sic] has asked Ed Meese to urge the Army to award this contract to Welbilt instead of to Chrysler. The Bronx needs the jobs.
>
> I think that, instead, Ed (by memo) or you, directly should simply ask for a status report, or for a copy of the response to this LAMA letter to Spurlock. Quite possibly, we should do nothing at all. Do you have existing guidance on this type of thing?

Mr. Jenkins told the Subcommittee staff that he was advised by Cabinet Secretary Craig Fuller not to get involved in the Welbilt matter, but decided to go ahead anyway, because "he [Mr. Fuller] wasn't my boss, so he couldn't tell me not to." [155] At a bench con-

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[144] Testimony of Mr. Meese (Nofziger Trial) at 3197, 3201.

[145] Testimony of Mr. Meese (Nofziger Trial) at 3224–25.

[146] Testimony of Mr. Meese (Nofziger Trial) at 3285.

[147] Testimony of Mr. Meese (Nofziger Trial) at 3229. The document to which Mr. Meese referred is a LAMA publication announcing the award of the contract to Welbilt in September 1982. In [illegible] separate bench conferences at the Nofziger trial, Independent Counsel McKay and Judge Flannery read a note from Mr. Jenkins to Mr. Meese, which is apparently attached to this memorandum, and states: "Though you cannot tell from reading any of this your personal go-ahead to me saved this project." Transcript of Nofziger Trial at 2413, 3228.

[148] Office of Government Ethics' Review of the Attorney General's Financial Disclosure, Hearing Record at 29 (July 9, 1987).

[149] Testimony of Mr. Jenkins (Nofziger Trial) at 2443.

[150] Testimony of Mr. Jenkins (Nofziger Trial) at 2503–06.

[151] Testimony of Mr. Jenkins (Nofziger Trial) at 2307.

[152] Testimony of Mr. Jenkins (Nofziger Trial) at 2308–09.

[153] Testimony of Mr. Jenkins (Nofziger Trial) at 2311, 2446. An undated memorandum from Mr. Denlinger to Mr. Jenkins, obtained from White House files, indicated that Welbilt President John Mariotta was "a strong Republican and Reagan supporter" and went on to list contributions Mr. Mariotta had made to various Republican organizations.

[154] Testimony of Mr. Jenkins (Nofziger Trial) at 2311–12, 2447.

[155] At a bench conference during the Nofziger trial, attorneys for Messrs. Nofziger and Bragg indicated that Mr. Fuller was prepared to testify, and had testified before the grand jury, that Mr. Jenkins was not acting properly or within White House guidelines when he intervened in the Welbilt matter. Transcript of Nofziger Trial at 1289–90.

ference at the Nofziger trial, Independent Counsel James McKay and Mr. Nofziger's counsel indicated that a handwritten note to Mr. Jenkins, initialed by Mr. Fuller (to which the Subcommitttee has not had access) states: "[S]trongly recommend no White House action be taken." [156] The former White House Counsel, Fred Fielding, told the Subcommittee staff that he, too, advised Mr. Jenkins either directly or through Mr. Fuller not to intervene on behalf of Welbilt. Mr. Fielding also recalled advising Mr. Meese's office on a second occasion that the Army engine contract was a government procurement matter in which the White House should not be involved and there should be no appearance of White House involvement.[157]

The White House policy on relations with procurement agencies expressly prohibits staff members from contacting procurement officials on behalf of relatives, friends, or business associates who have a financial interest in a contract.[158] Mr. Jenkins testified at the Nofziger trial that he was a good friend of Mr. Nofziger.[159] He also testified that he was aware of Mr. Bragg's relationship with Mr. Nofziger.[160]

Nonetheless, Mr. Jenkins did intervene directly in the Army engine contract. Former SBA Deputy Administrator Donald Templeman testified before the Subcommittee that Mr. Jenkins called him on several occasions in March or April 1982 to discuss the engine contract. In the first phone call, Mr. Jenkins told Mr. Templeman and that he had been given the task at the White House of bringing the parties together to see what could be done to award this contact in the South Bronx. In subsequent calls, Mr. Jenkins asked about the status of the contract and inquired into the way the 8(a) program works and the types of assistance the SBA would provide an 8(a) contractor.[161] Mr. Templeman testified that this was the only occasion in his tenure at the SBA that he would recall this level of White House interest in an 8(a) contract.[162]

On April 22, Mr. Jenkins wrote to the new Administrator, James Sanders, to state his interest in the Welbilt contract: "Ed Meese has asked me to look into the Welbilt problem . . . which has been too long on the back burner." (Mr. Jenkins testified that Mr. Meese had not asked him to look into the matter, and that he made this statement to get Mr. Sanders' attention.)[163] In early May, Mr. Sanders had successive meetings with Mr. Jenkins, Mr. Nofziger, and Mr. Denlinger to discuss Welbilt and the engine contract.[164]

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[156] Transcript of Nofziger Trail at 2325, 2332. The White House declined to show the Subcommittee handwritten messages, written on an April 16, 1982 memorandum and an April 22, 1982 letter, on the grounds that they include "lawyer-client materials"—in particular, the advice of the White House counsel's office.

[157] Mr. Fielding stated that he did not follow up on the matter and assumed that his advice had been implemented.

[158] October 1981 White House Staff Manual. The White House Counsel's Office informed the Subcommittee staff in December 1987 that this policy was still in effect.

[159] Testimony of Mr. Jenkins (Nofziger Trial) at 2290, 2470.

[160] Transcript of Nofziger Trial at 4355.

[161] Hearing Record, Part 1 at 25, 27, 35. *See* Testimony of Mr. Templeman (Nofziger Trial) at 2712–15, 2745.

[162] Hearing Record, Part 1 at 27.

[163] Testimony of Mr. Jenkins (Nofziger Trial) at 2450.

[164] Mr. Wallach stated in his interview that on May 4 he met with Mr. Jenkins and Mr. Jenkins told him about the meeting he was planning to convene about the engine contract. Transcript of June 29, 1987 interview of Mr. Wallach at 38, 44, 56–57.

First, on May 3, Mr. Sanders had lunch with Mr. Nofzinger and Mr. Bragg at their office.[165] As Mr. Sanders explained in his testimony before the Subcommittee: "I think they invited me to come to lunch, and I considered because of the prominence of Nofzinger that it would be useful to that." [166] Mr. Sanders testified before a Grand Jury in April 1987 that Messrs. Nofziger and Bragg "wanted to be convinced, I think, that I understood the importance of a contract like this to the administration." [167] In later testimony before the Subcommittee and at the Nofziger trial, however, Mr. Sanders stated that he could not remember any reference to a White House interest in the contract at the May 3 lunch.[168]

Second, on May 7, Mr. Sanders went to Mr. Jenkins office to meet with Mr. Jenkins at his request.[169] Mr. Jenkins testified at the Nofziger trial that Mr. Sanders said that the SBA was prepared to certify to Welbilt's competence to perform the contract and stated his understanding that Welbilt would get the contract if the "financing gap" could be closed.[170] Mr. Sanders testified before the Subcommittee that Mr. Jenkins explained the White House interest in Welbilt:

> Mr. SANDERS. I would characterize the statements Mr. Jenkins made as saying that the White House was interested in seeing that something happen in the South Bronx and the best prospect was through the 8(a) program, and it would appear that the Wedtech company was the only one that could do it. In that order.
>
> Senator LEVIN. It may have been in that order, but when you got to the bottom line finally, did that not constitute in your mind the expression of White House interest in getting the Army engine contract for Wedtech?
>
> Mr. SANDERS. Well, let me put it this way, Mr. Chairman. I am not trying to split hairs, but the issue was to find a minority contractor to get something done in the South Bronx. If another contractor had appeared and another contract, that would equally be considered, I am sure. But after all, there were no others that were being put forth by our system.
>
> Senator LEVIN. Did Mr. Jenkins express the hope that it would come to a successful conclusion?
>
> Mr. SANDERS. Oh, I am sure he did.[171]

Finally, on May 10, Mr. Bragg took Mr. Denlinger to Mr. Sanders' office to meet with the new SBA Administrator. Mr. Denlinger has testified that he had sought meetings with Mr. Sanders about other issues, but was unsuccessful.[172] On this occasion, Mr. Denlinger testified, he told Mr. Sanders that Welbilt would need $3 million of business development (BDE) grants and $2 million of advance payment loans from the SBA to get the contract. According to Mr. Denlinger, Mr. Sanders responded by saying that "it was an awfully big bite." [173] Mr. Sanders testified before the Subcommittee that he met with Mr. Denlinger two or three times a year to

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[165] Testimony of Mr. Sanders (Nofziger Trial) at 2532, 2550.

[166] Hearing Record, Part 1 at 130. Mr. Sanders testified that he knew prior to this lunch that Mr. Nofziger represented Welbilt. *Id.*

[167] Mr. Sanders confirmed at the Nofziger trial that he had made this statement. Testimony of Mr. Sanders (Nofziger Trial) at 2558.

[168] Hearing Record, Part 1 at 130; Testimony of Mr. Sanders (Nofziger Trial) at 2556.

[169] Testimony of Mr. Sanders (Nofziger Trial) at 2558.

[170] Testimony of Mr. Jenkins (Nofziger Trial) at 2343, 2457.

[171] Hearing Record, Part 1 at 132. *See* Testimony of Mr. Sanders (Nofziger Trial) at 2559. Mr. Sanders also testified that Mr. Jenkins never contacted him about any other matter. Hearing Record, Part 1 at 137.

[172] Testimony of Mr. Denlinger (Nofziger Trial) at 2057–58.

[173] Testimony of Mr. Denlinger (Nofziger Trial) at 2058–60.

discuss Hispanic issues, and that it was not unusual for him to have discussed Welbilt with Mr. Denlinger at one such meeting.[174]

c. The May 19 Meeting.—On May 19, 1982, Mr. Jenkins convened a meeting in the "Ward Room" in the White House basement to discuss the engine contract with federal agency officials.[175] Mr. Jenkins testified at the Nofziger trial that he went into the meeting with the objective of identifying the amount of the gap between the Army price and the Welbilt proposal, and of letting the agency officials know that he would permit no foot-dragging in providing assistance to bridge that gap:

> Well, I had—my main objective and my sole objective in calling the meeting was to identify the exact magnitude and specifically the dimensions of the financing gap that existed, and that the minority business firm needed help with, and if we could identify that gap between the assistance they were able to get and the price that the Army was willing to pay, we would then know precisely whether or not we could help them become qualified or not. So I went into the meeting with three main objectives. Number 1, I wanted to establish with them that I had had lots of experience in the nuts and bolts of these programs and that I was not going to stand for any foot dragging or fogging up the issue, that so often the bureaucracy holds off doing anything long enough to make the problem go ahead [sic], and they don't have to give any money to the people that needed it.
>
> Secondly, I wanted them to know that besides my knowing that I would be able to tell immediately if they were pulling this stunt, I wanted them to know that I wouldn't stand for it and that I would be talking to them directly, or their bosses about it, if I ran into any evidence of such foot dragging.
>
> And thirdly, I said the meeting specifically was not called to discuss the Army pricing. That was the Army's business, I was not going to go into it. Mr. Sculley offered a couple of times in the meeting to explain the Army's pricing, and I asked him not to do so because in an open meeting like that I didn't feel it was proper, so I summed it up and tried to express my feelings as much as I could by saying I was not going to stand for any bullshit.[176]

Messrs. Denlinger and Moreno, who attended the meeting for Welbilt, testified that Mr. Jenkins took a forceful approach and was impatient with arguments presented by the agency officials present.[177]

Assistant Secretary J.R. Sculley, who attended the meeting for the Army, testified that he saw the May 19 meeting as an effort to orchestrate the activities of several federal agencies on the engine contract.[178] Dr. Sculley and Mr. Jenkins both testified that Mr. Jenkins reminded the participants in the meeting of the President's campaign promise in the South Bronx. Dr. Sculley stated:

> [T]hat was the tone of the meeting, that a campaign visit had been made, it was—South Bronx was an area notorious for its high unemployment and that the placement of this contract in the South Bronx under this program would provide livelihood for rather large numbers of people and keep a campaign promise.[179]

Dr. Sculley told the Subcommittee staff that the Army's position did not change as a result of the meeting, but he became more

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[174] Hearing Record, Part 1 at 137.

[175] Testimony of Mr. Jenkins (Nofziger Trial) at 2354, 2454. Mr. Jenkins testified that he discussed the issue of who should attend with Mr. Bragg prior to the meeting. *Id.* at 2355–56. Mr. Jenkins was sure he told Mr. Meese of his plans to hold the meeting. *Id.* at 2355, 2453. Mr. Meese testified that he does not recall whether he was told or not. Office of Government Ethics' Review of the Attorney General's Financial Disclosure, Hearing Record at 29 (July 9, 1987).

[176] Testimony of Mr. Jenkins (Nofziger Trial) at 2357–58.

[177] Testimony of Mr. Denlinger (Nofziger Trial) at 2063–64; Testimony of Mr. Moreno (Nofziger Trial) at 1862–63.

[178] Testimony of Dr. Sculley (Nofziger Trial) at 2894.

[179] Testimony of Dr. Sculley (Nofziger Trial) at 2895–96.

amendable to Welbilt and left with the attitude that it would be a good idea to award the contract under the 8(a) program.[180]

Mr. Templeman, who attended the meeting for the SBA,[181] testified that he went to the White House prepared to commit the SBA to give Welbilt $3 million in business development (BDE) grants and $2 million in advance payment loans.[182] Mr. Templeman testified before the Subcommittee that although the SBA was legally authorized to commit these funds to Welbilt, it never would have done so, had it not been for the White House interest in the contract:

> Senator LEVIN. . . . You indicated to [the Subcommittee staff] that the reason that you were willing to go along with such a large grant of BDE funds was that is is hard to resist, when you are in a meeting in the West Wing of the White House.
> Mr. TEMPLEMAN. That is true.
>
> * * * * * * *
>
> Senator LEVIN. Now you also indicated to them, that in a normal situation, we would have resisted. When you are in the White House, and believe you are trying to help the President, you do what you can.
> Mr. TEMPLEMAN.That is true, too.
> Senator LEVIN. That is true, too. And also, as these notes indicate, you specifically told our staff, that without the White House interest, "I never would have gone along with something like that because we were trying to cut down on the long-timers in the program."
> Mr. TEMPLEMAN. That is true, too. I am sure that had we not had that level of interest, and what we thought was the motivation there to get those jobs in the South Bronx, that we would have resisted much more strongly, and in fact would never have awarded a total of $5 million worth of assistance to one contractor.[183]

Mr. Templeman explained that he was troubled not only by the amount of the assistance given to Welbilt—half of the SBA's BDE expenditures for the entire fiscal year—but also by the question whether it was being put to good use. According to Mr. Templeman, (1) Welbilt was basically a sheet metal company that had never produced anything of this complexity before; (2) the engine contract was a one-time contract with no promise of follow-on work; and (3) the contract was likely to cause management problems for the company because it would be ten times the size of Welbilt's largest previous contract.[184] As Mr. Templeman concluded in his testimony before the Subcommittee, he was "concerned with the Army getting the engines near the price, near the time they needed them."[185]

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[180] Dr. Sculley testified at the trial of Messrs. Nofziger and Bragg that he agreed that "in the spirit of things I would take another hard review of our position." Testimony of Dr. Sculley (Nofziger Trial) at 2915.

[181] Mr. Templeman testified that Mr. Sanders was aware of the meeting and that he (Mr. Templeman) attended because he was the senior SBA official with detailed knowledge of the contract. Hearing Record, Part 1 at 28; Testimony of Mr. Templeman (Nofziger Trial) at 2717. Mr. Sanders testified that he is sure he asked Mr. Templeman to attend and was briefed on the meeting after it took place. Hearing Record, Part 1 at 131; Testimony of Mr. Sanders (Nofziger Trial) at 2560.

[182] Hearing Record, Part 1 at 26. Mr. Templeman testified that his commitment was approved by Mr. Sanders prior to the meeting. Testimony of Mr. Templeman (Nofziger Trial) at 2716. Mr. Sanders testified that he was the only one with authority to commit this amount of SBA funds and he assumes Mr. Templeman discussed it with him prior to the meeting. Hearing Record, Part 1 at 138.

[183] Hearing Record, Part 1 at 29–30.

[184] Hearing Record, Part 1 at 24, 34, 40.

[185] Hearing Record, Part 1 at 38.

Mr. Sanders testified before the Subcommittee that he could not remember Mr. Templeman expressing these concerns at the time of the award to Welbilt.[186] However, Mr. Sanders did share Mr. Templeman's concern about the amount of assistance granted to Welbilt: "[I]t was extraordinary . . . and I knew we were biting off a big piece."[187] Further, Mr. Sanders agreed that he never would have committed so much aid to a single company, had it not been for the White House interest.[188]

d. Negotiation and Award.—At the close of the May 19, 1982 meeting, Welbilt representatives committed themselves to submit a new proposal to the Army.[189] Welbilt reduced its price to $26 million and sent this proposal directly to Assistant Secretary Sculley on May 20. This new proposal contained no backup data (normally included with a proposal) explaining the breakdown of Welbilt's costs and how the company expected to perform the contract for this price. However, Welbilt President John Mariotta explained in a cover letter to Dr. Sculley that the price reduction was made possible by $8.25 million in financing to be provided by government and private sources, including $5 million of anticipated SBA Business Development Expense (BDE) grants and advance payment loans.[190]

Welbilt officials and consultants apparently started to get nervous about the contract when a week passed without any response to their new proposal from the Army.[191] On May 27 and 28, 1982, Mr. Denlinger called Mr. Bragg, who called Mr. Jenkins and Mr. Spurlock to discuss the problem.[192] On May 28, Mr. Denlinger transmitted a letter from Nofziger and Bragg Communications to Mr. Jenkins, seeking his assistance in obtaining a "letter of intent" from the Army to help Welbilt obtain additional financing.[193] A week later, on June 3, Mr. Denlinger transmitted a second letter, with a similar request for assistance from Mark Bragg, to Mr. Sanders.[194]

Copies of both letters were sent to Assistant Secretary of the Army J.R. Sculley. Dr. Sculley testified at the Nofziger trial that these letters did not receive serious consideration from the Army, because the Army does not issue letters of intent.[195] On June 8

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[186] Hearing Record, Part 1 at 147, 154.

[187] Hearing Record, Part 1 at 140.

[188] Hearing Record, Part 1 at 138. An SBA memorandum on June 4, 1982 states that "President Reagan ordered the contract signed" and that the BDE and advance payments would have to be processed as "a crash program." Memorandum from Mr. Murtagh re: June 4, 1982 meeting.

[189] Testimony of Mr. Moreno (Nofziger Trial) at 1929; Testimony of Mr. Denlinger (Nofziger Trial) at 2064.

[190] *See* Testimony of Mr. Templeman (Nofziger Trial) at 2731-32, 2735; Testimony of Mr. Moreno (Nofziger Trial) at 1950.

[191] Testimony of Mr. Denlinger (Nofziger Trial) at 2134-37, 2183-84.

[192] Testimony of Mr. Denlinger (Nofziger Trial) at 2073-76, 2103-06; Testimony of Mr. Jenkins (Nofziger Trial) at 2365-67, 2466, 2417, 2524.

[193] This letter was typed on the stationery of Nofziger and Bragg Communications and was signed "Lyn" over the typed signature line "Lyn Nofziger". However, Mr. Nofziger was at home recuperating from a heart attack at the time the letter was sent and there is considerable doubt as to who signed the letter and even as to whether the letter was intended for Mr. Jenkins. *See* Testimony of Mr. Denlinger (Nofziger Trial) at 2078-85, 2139-46. Messrs. Nofziger and Bragg were acquitted on counts of illegal lobbying relating to this letter in February 1988.

[194] Mr. Bragg was in the British Virgin Islands at the time this letter was sent. However, Mr. Denlinger testified that Mr. Bragg orally approved the letter and directed a secretary at Nofziger and Bragg Communications to sign it on his behalf. Testimony of Mr. Denlinger (Nofziger Trial) at 2086-94, 2150-53.

[195] Testimony of Dr. Sculley (Nofziger Trial) at 2936-37.

and 9, however, Assistant Secretary Sculley informed Welbilt and the SBA that the Army would negotiate with Welbilt if the SBA endorsed Welbilt's financing plan and provided "adequate assurance" that funds would be available to Welbilt in the amount necessary to allow performance.[196] On June 11, 1982, Assistant Secretary Sculley's office informed TSARCOM that he had agreed to negotiate with Welbilt if the SBA endorsed Welbilt's financing plan. On June 17, the Army sent the SBA a formal request for a new proposal, including the SBA's endorsement of the financing plan.[197]

At about the same time, Mr. Jenkins called Mr. Templeman to inquire why the SBA had not yet formally committed BDE and advance payment money for the Welbilt contract.[198] Mr. Templeman testified that he responded to this telephone call by expediting a letter of commitment to assist Welbilt for Mr. Sanders' signature.[199] As a result, Mr. Sanders signed the letter on June 18, 1982—ten days before Welbilt formally requested the assistance.[200] Mr. Sanders testified before the Subcommitte that he was "surprised" and "disappointed" to learn of the "irregular" procedure which was followed in bringing this letter to him for signature before the assistance had been formally requested.[201]

On August 6, the SBA sent the Army a letter endorsing Welbilt's financing plan [202] and on August 11, Dr. Sculley directed TSAR COM to make "all possible efforts" to award the contract to Welbilt by September 30, 1982.[203] Dr. Sculley told the Subcommittee staff that he could not remember whether Secretary Marsh, Under Secretary Ambrose, or he made the decision to negotiate a contract with Welbilt. Secretary Marsh told the Subcommittee staff that he did not make the decision to go with Welbilt, but he did approve it. TSARCOM procurement officials have told the Subcommittee staff that they did not want to contract with Welbilt, and did so because of this express directive from the Assistant Secretary's office.[204]

Assistant Secretary Sculley's top procurement aides, George Dausman and Robert Stohlman, told the Subcommitte staff that the Army agreed to negotiate with Welbilt because the financing

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[196] June 8, 1982 letter from Dr. Sculley to Mr. Mariotta; June 9, 1982 letter from Dr. Sculley to Mr. Sanders. On June 7, 1982, Brigadier General James Hesson, the Deputy Commander of TSARCOM, sent a memorandum to his superiors warning that the Army's failure to reach a decision whether to set aside the engine contract was starting to have an adverse impact on military readiness.

[197] June 11, 1982 telex from the Assistant Secretary's office to TSARCOM; June 17, 1982 letter from Dr. Keenan to Mr. Quigley.

[198] Testimony of Mr. Templeman (Nofziger Trial) at 2728. An undated memorandum in Mr. Jenkins' files states that Mr. Bragg had called to say that Mr. Templeman was waiting for a phone call giving him the go-ahead to negotiate with the Army.

[199] Testimony of Mr. Templeman (Nofziger Trial) at 2728.

[200] June 18, 1982 letter from Mr. Sanders to Mr. Mariotta; June 28, 1982 letter from Mr. Mariotta to Mr. Neglia. Mr. Moreno testified that Mr. Neglia asked Welbilt to submit a request for the assistance after Mr. Sanders' letter had been sent out. Testimony of Mr. Moreno (Nofziger Trial) at 1882–83, 1886.

[201] Hearing Record, Part 1 at 139.

[202] August 6, 1982 letter from Mr. Rogers to Mr. Beckham.

[203] August 11, 1982 telex from Dr. Sculley to TSARCOM and DARCOM. This expedited schedule was apparently dictated by Welbilt's financing requirements. *See* August 26, 1982 memorandum from Dr. Keenan.

[204] May 14, 1987 interview of Dr. Keenan; May 11, 1987 interviews of Mr. Murray and Mr. Beckham.

plans submitted by the company enabled Welbilt to reduce the price of earlier proposals.[205]

However, most elements of Welbilt's financing plan could not have been a basis for price reductions, because more than $3 million of the $4 million in grants included in the plan had already been anticipated in earlier financing plans that Welbilt provided to the SBA even before it submitted its first contract proposal in 1981.[206] An additional $3.6 million included in the plan was expected in the form of loans, which ultimately would have to be repaid by Welbilt.[207] Mr. Dausman acknowledged to the Subcommittee staff that some of the funds in Welbilt's financing plans were loans, not grants, and would have to be repaid by the company. Mr. Dausman stated that these loans could not be repaid out of the proceeds of the contract, but that he was not concerned with how Welbilt was going to pay them back and remain financially solvent.

Defense Department documents indicate that Welbilt's proposed costs were unrealistically low, raising the danger that the company would not be financially capable of performing the contract. First, in early August 1982, the Defense Supply Agency notified TSARCOM that Welbilt's bill of materials was two years out of date and underpriced by $4 million.[208] Second, in late August, an audit by the Defense Contract Audit Agency (DCAA) concluded that, because of discrepancies in Welbilt's proposal, the company was likely to overrun the contract by at least $200,000.[209] Third, a Defense Contract Administrative Services Management Area (DCASMA) price analyst reviewed the proposal and concluded that Welbilt's estimates for material and labor costs were overly optimistic.[210] Jim Beckham, the procuring contract officer, told the Subcommittee staff, "It seemed like they [Welbilt] were trying to bankrupt themselves."[211]

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[205] May 20, 1987 interview of Mr. Dausman; March 25, 1987 interview of Mr. Stohlman. *See* Testimony of Dr. Sculley (Nofziger Trial) at 2942 (negotiations possible because of reductions in Welbilt's price and contributions from other agencies).

[206] December 12, 1980 and January 12, 1981 letters from Mr. Mariotta to Mr. Quigley (anticipating $2 million in BDE grants and $1.275 million in UDAG grants); *see* September 2, 1981 memorandum from Mr. Quigley to Mr. Washington (transmitting $10 million financing plan underlying Welbilt's 1981 proposal); September 18, 1981 letter from Mr. Mariotta to Mr. Washington outlining Welbilt's financial arrangements underlying the 1981 financing plan. Of the $8.25 million included in the May 20 financing plan, $4.125 million was committed to facilities expenses that could not have been charged directly to the government in any case. Facilities expenses are normally capitalized and depreciated; only the portion of depreciation allocable to the performance of a specific contracts may be charged to that contract.

[207] Includes $2 million in SBA advance payments; $600,000 from Manufacturers' Hanover; and $1 million from Granrich Corp for the leasing of equipment. *See* May 20, 1982 letter from Mr. Mariotta to Dr. Sculley.

[208] August 2, 1982 memorandum from Messrs. Castiglioni and Raps; August 5, 1982 memorandum from Mr. Snyder. TSARCOM documents indicate that Welbilt submitted a new bill of materials without any substantial adjustment to the prices quoted. August 16, 1982 telex from TSARCOM to DARCOM.

[209] August 24, 1982 Audit Report on Evaluation of FFP Proposal No. DAAJ09-82-R-A600 Submitted by Welbilt Electronic Die Corp.

[210] August 27, 1982 Pricing Review and Analysis, Welbilt Electronic Die Corporation Contract #DAAJ09-82-R-A-600. DCASMA did not consider the question whether Welbilt would overrun the contract when it found the company financially capable of performing. However, the DCASMA financial analyst did note that Welbilt's sales had shown an 800% growth over two years and that "this growth rate cannot continue at this pace, for the company's growth would outstrip its financing, as a matter of simple economics." September 3, 1982 Pre-Award Survey (Part III—Financial Capacity).

[211] May 11, 1987 interview of Mr. Beckham.

In August 1982, the Army raised its Fair Market Price from $23.6 million to $27.8 million. There were three major components of this change: (1) the Army added $1.2 million to cover additional inflation due to the delay in letting the contract; (2) the Army added $1.7 million to cover the costs of a new contract requirement; and (3) the Army agreed to increase the FMP by $1 million to offset the value of government-furnished equipment that would not be available to Welbilt.[212] These increases in the FMP, together with the reductions in Welbilt's proposal, brought the negotiations to a successful conclusion.

On September 13, 1982, Welbilt accepted the Army's proposed price of $27.7 million,[213] and on September 27 and 28 the contract was signed. On October 4, a more formal signing ceremony was held at Welbilt, with federal, state and local officials in attendance.[214] On September 13 and again on October 8, White House records indicate that Mr. Bragg called "very happy" to offer his thanks and congratulations to Mr. Jenkins on the award to Welbilt. In a note from Mr. Jenkins to Mr. Meese at about the same time, Mr. Jenkins stated that "your personal go-ahead to me saved this project." [215]

Within a month after the award of the engine contract, by October 1982, Welbilt was experiencing severe financial difficulties.[216] In January 1983, the SBA and the Army learned that Welbilt was not paying its vendors, who were starting to demand cash in advance, thereby slowing down Welbilt's production and deliveries. Also in January, the Internal Revenue Service discovered that Welbilt had illegally used employee withholding money to cover cash flow problems and threatened to seize the company's assets.[217] Four former Welbilt officials recently pled guilty in federal court to charges that they falsified progress payment requests to the government at about this time in an effort to remain in business. One Army official remembers Welbilt President John Mariotta saying at a post-award conference on the engine contract "We are doing everything we can [to perform the contract] that doesn't cost money." [218]

Welbilt's initial deliveries were a year late, and its final deliveries in 1986 were two years behind the original contract schedule.

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[212] September 13, 1982, DAR 3-811 Price Negotiation Memorandum; May 11, 1987 interview of Mr. Beckham.

[213] September 13, 1982 letter from Mr. Mariotta to Mr. Romain; September 13, 1982 letter from Mr. Rogers to Mr. Murray; September 13, 1982 telex from Mr. Murray to Mr. Romain.

[214] Attendance list for October 4, 1982 signing ceremony. White House records indicate that Mr. Wallach, Mr. Jenkins, Mr. Zuniga and Mr. de Baca all pushed hard for the President to attend this signing ceremony. August 3, 1982 letter from Mr. de Baca to Ms. Dole; August 25, 1982 memorandum from Mr. Zuniga to Ms. Dole; August 27, 1982 letter from Mr. de Baca to Ms. Dole; August 31, 1982 memorandum from Mr. Wallach to Mr. Jenkins ("A long time ago, Ed and I spoke about a possible media event at Welbilt including the President."); undated memorandum from Mr. Jenkins to Mr. Bragg ("I have suggested to Dole (urged) that the President go to the South Bronx to award the certificate of excellence and the Army contract. If Lyn agrees, he should find some way to needle Deaver on it."); September 20, 1982 memorandum from Mr. Zuniga to Mr. Cavaney.

[215] This note was read by Independent Counsel McKay and Judge Flannery during two separate bench conferences at the Nofziger Trial. Transcript at 2413, 3228.

[216] October 9, 1987 interview of Mr. Moreno; April 28 interview of Mr. Liebman.

[217] January 17, 1983 letter from Mr. Liebman to Mr. Mariotta; February 15, 1983 memorandum from Mr. Romain regarding February 10 meeting with Defense Department and Welbilt officials. *See* Hearing Record, Part 1 at 49 (Testimony of Mr. Rogers).

[218] June 3, 1987 interview of Mr. Austin.

TSARCOM officials told the Subcommittee staff that though Welbilt produced top-quality engines,[219] it delivered only 4,892 of the 13,100 engines that it contracted to build. The company was paid approximately $22 million of the $27.7 million contract amount, leaving the Army with an out-of-pocket loss of $12.5 million for engines that it paid for, but will never be delivered by Welbilt.[220] As Secretary Marsh commented when informed of these statistics by the Subcommittee staff, the company's ultimate performance confirmed the Army's earlier concerns about its price.[221]

4. DISCUSSION AND FINDINGS

a. The Merits of the Award.—There was a valid social policy reason for awarding the Army engine contract to Welbilt. Welbilt was located in the South Bronx, a depressed area to which two Presidents had promised to bring industry and jobs. In 1981 and 1982, the company had a strong record of employing the hard-core unemployed and at the same time delivering a quality product (primarily repair kits for the Tank Command) on schedule. Moreover, Welbilt planned to hire 300 new employees to build the engines, making it one of the largest employers in the South Bronx.

From a procurement standpoint, the Army reviewed Welbilt's production plans and found them adequate to perform the contract. Welbilt itself bore the burden of meeting the Army's price, reducing its proposal from $99 million to $38 million and ultimately to $27 million. Although the Army raised its Fair Market Price by $8 million over two years, it gave objective reasons for these adjustments, and there is no basis for concluding that the final price negotiated with Welbilt was unreasonably high.

At the same time, however, there were substantial procurement policy reasons why the contract should not have been awarded to Welbilt. Welbilt had never built any product of comparable complexity before, and had only an empty building reserved for the performance of the contract. While the Army concluded that Welbilt would be able to overcome these handicaps and complete the contract, it also concluded that Welbilt's price would be far more than that of an established engine manufacturer.

Welbilt's agreement to reduce its price in 1982 alleviated the price problem, but created a second problem: the company's price had been reduced, but not its costs, creating a real danger that the company might go bankrupt trying to perform. Contemporaneous documents indicate that the Army was, or should have been, aware of this danger. Indeed, Wedtech's current lawyer, Martin Pollner, who has cooperated with federal investigators, testified before the Subcommittee that Welbilt had intentionally underbid this and other contracts with the knowledge that it would lose money. Mr. Pollner characterized the company's bidding practices as a "Ponzi scheme" designed to raise more and more money until the bubble finally burst.[222]

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[219] May 11, 1987 interview of Mr. Murray; June 3, 1987 interview of Mr. Austin.
[220] This information was provided over the telephone to the Subcommittee staff by Dr. Sculley's office.
[221] March 7, 1988 interview of Secretary Marsh.
[222] Hearing Record, Part 1 at 12–13.

As Senator Cohen explained in a colloquy with former SBA Deputy Administrator Donald Templeman, the size of the contract alone locked Welbilt and the SBA into an upward spiral in which the company needed more and more contracts in order to survive:

Senator COHEN. . . . Didn't that present a lot of management problems, a firm that small with business not exceeding $2 million a year, suddenly being given a $27 million contract?

Wasn't there a real management problem with that?

Mr. TEMPLEMAN. Oh, absolutely. That's a tenfold upscale in operations. And as I said in response to the Chairman's question, I think that one of the major problems in the program, is that they do just this sort of thing.

Senator COHEN. And the solution, on the part of SBA, and others would have been to get them more contracts. To balloon itself up to $27 million management capability, you have got to then sustain it at that level, and that means more contracts, does it not?

Mr. TEMPLEMAN. Yes.

Senator COHEN. And that is what happened here, going from an Army contract, to a Navy contract, with other Government programs basically feeding this ballooning of the firm. Is that right?

Mr. TEMPLEMAN. Yes . . .[223]

The Subcommittee finds that while there was a valid social policy reason why the Army engine contract should have been awarded to Wedtech and while the Army found Welbilt to be capable of performing the contract, given enough time and money, there were substantial procurement policy reasons why the contract should not have been awarded to Wedtech.

b. The Reasons for the Award.—In 1981, the Army rejected Welbilt's proposal for the Army engine contract on the ground that it was out of the negotiating range. Welbilt's proposal at that time was almost twice the Army's estimated fair market price, leading Army officials to believe that an audit of the proposal would be a waste of time and money. In September 1981, nonetheless, Army officials changed their minds and agreed to audit Welbilt's proposal.

The Army's decision to audit the Welbilt proposal followed numerous requests from Congressmen, Congressional staffers and White House aides. Both Congressional and White House officials pointed to Welbilt's location in the South Bronx and emphasized the social benefits of an award to Welbilt.

Robert Stohlman, an aide to Assistant Secretary of the Army J.R. Sculley, testified at the Nofziger trial that he decided to proceed with the audit because of the pressure from the White House and the Congress. Officials at the procurement command responsible for the contract have told the Subcommittee staff that they audited the Welbilt proposal only because directed to do so by Dr. Sculley's office. *For these reasons, the Subcommittee finds that Wedtech's proposal would not have been audited in 1981, but for the intervention of the White House and the Congress.*

At a May 19, 1982 meeting in the White House, former SBA Deputy Administrator Donald Templeman committed the SBA to grant Welbilt $3 million in Business Development Expense (BDE) grants and $2 million in advance payment loans to assist in the performance of the engine contract. Mr. Templeman testified before the Subcommittee that he was troubled by the size of the

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[223] Hearing Record, Part 1 at 40–41.

BDE grant to Welbilt—more than half of the SBA's BDE expenditures for the entire 1982 fiscal year—and by the question whether it was being put to good use. As Mr. Templeman explained, he understood that the engine contract was basically a one-time contract and was concerned that the SBA's expenditures would be wasted on facilities that would be useful for only one project. Former SBA Administrator James Sanders testified that he was not aware of Mr. Templeman's specific problems with Welbilt, but shared his concerns about the size of the BDE grant.

Both Mr. Sanders and Mr. Templeman testified before the Subcommittee that they would not have committed this much assistance to a single 8(a) company, had it not been for the interest of the White House in this contract. Senator Levin summarized this testimony in a colloquy with Mr. Templeman:

> Senator LEVIN. You had the authority to give this kind of money out, although you thought it was unwise to exercise it. You had the technical, legal authority to give an amount of Business Development Expense grant in the amount that you did. You never had exercised it anywhere near that amount.
>
> You had expressed, in writing, to the Army, the feeling that it would really raise questions about administration of the program for even $1 million, or a multi-million dollar amount of BDE money to be given to one firm.
>
> So you obviously had some feelings about this. Your own feelings were set aside, overridden by your desire to please the White House, basically. Is that fair?
>
> Mr. TEMPLEMAN. That is correct.[224]

Both Mr. Sanders and Mr. Templeman emphasized their understanding that the White House was interested in bringing business and jobs to the South Bronx, and that Welbilt was the vehicle through which this end was to be accomplished. For this reason, Mr. Sanders and Mr. Templeman saw the SBA's commitment of funds to Welbuilt as implementing a social policy decision by the White House—although not a decision that they would have reached on their own.

The Subcommittee finds that the SBA awarded $3 million in Business Development Expense grants and $2 million in advance payment loans to Wedtech despite the belief of high SBA officials that this award was excessive in amount and was a poor use of the agency's limited funds. The Subcommittee further finds that the SBA would not have made this award, but for the intervention of the White House.

On April 16, 1982, Secretary of the Army John Marsh met with top Army procurement officials and firmly decided that the engine contract would be withdrawn from the 8(a) program and offered for competitive bidding. That same day, the Army sent out letters notifying the Small Business Administration, the Latin American Manufacturers' Association, and two Congressmen of this decision.

Nonetheless, a solicitation for competitive bids was never issued. Assistant Secretary J.R. Sculley has testified that he attended a May 19, 1982 meeting at the White House, at which Mr. Jenkins emphasized the White House interest in fulfilling a campaign promise to bring jobs to the South Bronx. Dr. Sculley has testified and told the Subcommittee staff that the Army's position did not change as a result of the White House meeting, but that he left the meeting with a more favorable attitude toward Welbilt.

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[224] Hearing Record, Part 1 at 38.

After the May 19 meeting, the Army received a new Welbilt proposal, which was referred to the responsible command for negotiation. Dr. Sculley stated that the negotiations with Welbilt were made possible by reductions in Welbilt's price and by financial assistance provided by other federal agencies, including the SBA. However, Dr. Sculley also acknowledged that the Army would have followed through on its decision to offer the contract for competition, had it not been for the White House meeting: "The Army's position did not change in relation to price. The course [by which] we obtained the engines changed." [225] Officials at the command responsible for the contract have confirmed that they would not have negotiated with Welbilt, had they not received a directive from Dr. Sculley's office to do so. *Accordingly, the Subcommittee finds that the Army would not have awarded the engine contract to Wedtech, but for the intervention of the White House.*

c. The White House Role.—The role of the White House in Welbilt's effort to obtain the Army engine contract was mixed. On the one hand, White House officials have testified at the Nofziger trial and told the Subcommittee staff that their involvement in the effort to obtain the engine contract for Welbilt was based on a desire to fulfill the President's campaign promise to bring jobs and industry to the South Bronx, a legitimate objective for the President's staff. Various White House documents confirm this. On the other hand, the intervention of Mr. Meese and his deputy, Mr. Jenkins, appears to go beyond this purpose and to have been due in no small part to the influence of Welbilt consultants and Mr. Meese's personal friends E. Robert Wallach and Lyn Nofziger. Mr. Jenkins was also a a personal friend of Mr. Nofziger and was aware of the relationship between Mr. Meese and Mr. Wallach.

Mr. Meese testified at a Subcommittee hearing that in the summer of 1981 he asked his staff to ensure that Welbilt got a "fair hearing" after receiving several detailed memoranda from, and having conversations with, his friend Mr. Wallach. Mr. Meese further testified that at the time he received Mr. Wallach's memoranda, he was aware that Mr. Wallach was a Welbilt consultant, but did not know whether he was paid or unpaid. (Mr. Wallach was apparently unpaid at the time of his initial contacts with Mr. Meese, but began receiving payments that ultimately totalled more than $1 million soon after the award of the engine contract.) In a letter to Mr. Meese dated April 8, 1982, Mr. Nofziger, a longtime personal friend of Mr. Meese, followed up on an earlier discussion about Welbilt, the South Bronx, and the Army engine contract and stated: "Ed, I really think it would be a blunder not to award that contract to Welbilt." Mr. Meese testified at Mr. Nofziger's trial that he knew Mr. Nofziger was working in the private sector as a consultant.

Mr. Jenkins has testified that he convened a meeting in May 1982 at the White House to facilitate the award of the engine contract to Welbilt because of his interest in assisting a minority small business. Mr. Jenkins testified that he first became aware of Welbilt's efforts to get the engine contract at a mid-April 1982 meeting

[225] Testimony of Dr. Sculley (Nofziger Trial) at 2943.

with Mark Bragg—Mr. Nofziger's partner—and Stephen Denlinger of the Latin American Manufacturer's Association. However, White House documents indicate that Mr. Jenkins received a copy of a January 1982 memorandum from Mr. Wallach to Mr. Meese and a copy of the April 8, 1982, letter from Mr. Nofziger to Mr. Meese, both of which sought Mr. Meese's assistance on behalf of Welbilt. Mr. Jenkins stated to the Subcommittee staff that he does not remember seeing either Mr. Wallach's memorandum or Mr. Nofziger's letter in 1982.

Mr. Jenkins testified that he was aware of the close personal relationships between Messrs. Wallach and Nofziger and Mr. Meese, that he himself was a close personal friend of Mr. Nofziger and that he knew that Messrs. Nofziger and Bragg were paid Welbilt consultants at the time he intervened on the company's behalf. Two letters written by Mr. Jenkins to SBA Administrator James Sanders and Senator Robert Kasten on April 22, 1982, and July 27, 1982, state that Mr. Jenkins intervened in the Welbilt procurement at the request of Mr. Meese, and a note written by Mr. Jenkins to Mr. Meese in Fall 1982 states that "your personal go-ahead to me saved this project". Mr. Jenkins testified that Mr. Meese did not direct him to take any action on behalf of Welbilt, but did approve of his intervention. Mr. Jenkins also stated that he used Mr. Meese's name in his letters to Mr. Sanders and Senator Kasten to get their attention.

When White House officials intervene in a procurement matter for any reason, the consequences are likely to be significant because of the power of the White House. There may be appropriate circumstances for White House officials to intervene in a procurement matter—provided that applicable procurement laws and regulations are observed—but even then, intervention should be undertaken with great care and acute awareness of the possible consequences. Where White House intervention in a procurement is prompted by a personal relationship between a White House staff member and a friend or relative, there is a strong appearance of improper favoritism which can only undermine the public's faith in the integrity of the procurement process.

Senators Levin and Cohen summarized at the Subcommittee hearings how the influence exercised by Welbilt's consultants places a cloud over the more noble reasons for awarding the contract to Welbilt. Senator Levin stated:

> What you have here is a perfectly appropriate feeling of a President that he wants to do something about unemployment in the South Bronx. And then you have got people who were formerly in the Administration, friends of people in the Administration cashing in on that for their own huge benefit, millions in their own pocket.[226]

Senator Cohen stated:

> Here you were trying to create some job opportunities in an area that was an economic wasteland and the people attacked that fish with a vengeance and pulled off millions of dollars for their own and let the fish itself die.
>
> It is a rather shocking example of what takes place when people are hired not simply based upon their expertise but their access and their influence and how they can manipulate the system to their own economic advantage.[227]

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[226] Hearing Record, Part 1 at 143.
[227] Hearing Record, Part 1 at 142.

A formal White House policy on procurement matters, which has been in effect since October 1981, addresses this very issue. That policy prohibits White House staff members from intervening in specific procurements or contacting procurement officials on behalf of friends, relatives or associates who have a financial interest in the matter. The policy also provides strict limitations on White House involvement even where there is no financial or personal relationship. Where there is a legitimate White House interest in a procurement matter, the policy acknowledges a right only to receive information. Even then, such information is to be obtained by a disinterested person and, to the extent possible, after the contracting process has been completed and from officials who are not decision-makers. In any event, White House staff members are informed that they should consult with the White House Counsel's office prior to any contact with a procurement agency.

Based on the evidence obtained by the Subcommittee, Mr. Meese and Mr. Jenkins violated this White House policy. Both Mr. Meese and Mr. Jenkins went beyond merely seeking information—Mr. Meese by giving Mr. Jenkins the go-ahead to assist Welbilt and by his awareness and at least tacit approval of the May 19th meeting, and Mr. Jenkins by convening the May 19th meeting on the engine contract in order to identify the gap between the Army price and the Welbilt proposal and let agency officials know that he "was not going to stand for any foot dragging" in addressing the gap. Although the White House policy expressly prohibits intervention by a White House staff member in matters in which a friend has a financial interest, Mr. Meese apparently did not seek to determine whether Mr. Wallach had such an interest, and he apparently knew that Mr. Nofziger did. Mr. Jenkins has testified that he knew of Mr. Nofziger's financial interest in Welbilt.

Mr. Meese does not appear to have made any effort to limit his subordinates to obtaining information or contacting agency procurement persons not involved in the decision-making process as the White House policy prescribes; Mr. Jenkins intervened with officials who were directly involved in that process. The activities of both Mr. Jenkins and Mr. Meese took place while the contracting procedure was still under way.

The former Counsel to the President, Fred Fielding, has told the Subcommittee staff that he specifically advised Mr. Meese's office not to intervene in the Welbilt matter on two separate occasions. According to Mr. Fielding, he stated that the Army engine contract was a government procurement matter, in which there should be no White House involvement and no appearance of White House involvement. Mr. Jenkins told the Subcommittee staff that he consulted with Cabinet Secretary Craig Fuller prior to calling a meeting on the engine contract, but that he disregarded Mr. Fuller's advice not to intervene in the matter, because "he wasn't my [Mr. Jenkins'] boss". Mr. Meese was Mr. Jenkins' boss.

For these reasons, the Subcommittee finds that Mr. Meese and Mr. Jenkins failed to observe the White House policy on contacts with procurement officials, which failure resulted in improper favoritism toward a specific contractor.

B. The SBA's Approval of Wedtech's 8(a) Eligibility

1. THE PUBLIC STOCK OFFERING

a. The Termination Recommendation.—In April 1983 Wedtech decided to address its financial difficulties by raising money through a public stock sale. Wedtech retained Moseley, Hallgarten, Estabrook & Weeden Inc. (now Moseley Securities) to underwrite the offering and Squadron, Ellenoff, Plesent & Lehrer to provide legal advice. Arthur Siskind, a partner in the Squadron, Ellenoff Law firm, told the Subcommittee staff that Wedtech "was in desperate trouble" in mid-1983 and there were several occasions when the company did not have enough money to meet its payroll. Mr. Siskind stated that he helped put together "a whole series of separate [financing] transactions to raise interim money" before the stock offering could be completed.

On August 25, 1983, Wedtech filed a prospectus with the SEC and became the first 8(a) company ever to go public. Wedtech sold 1.9 million shares to the public at an initial public offering price of $16.00 per share. Most of these shares—1.5 million—were new shares sold by the company; the remaining 400,000 were existing shares sold by the company's principal shareholders—John Mariotta, Fred Neuberger and Mario Moreno. Of the $27.6 million raised in the sale, $21.7 million went to the company and $5.9 million to the company's individual owners.[1]

As a result of the sale, John Mariotta, Wedtech's certified disadvantaged owner, was left with only 26.7 percent of the company's stock, substantially less than the 51 percent required for participation in the 8(a) program.[2] Former Wedtech Executive Vice President Mario Moreno has told the Subcommittee staff that Wedtech officials assumed that the company would be terminated from the 8(a) program as a result of the public stock offering. Wedtech's belief that it was no longer qualified for the program was reflected in the prospectus for the stock sale, which stated that the company "may no longer be eligible to participate in the Section 8(a) Program" as a result of the offering.[3] An earlier, preliminary prospectus, dated July 1, 1983, stated more conclusively that the company would be ineligible:

> Upon the issuance of the shares offered hereby, the Company will no longer be qualified to obtain new contracts under the Section 8(a) Program. Consequently, the Company will be required to obtain contracts through competitive bidding . . .
>
> Upon completion of this offering, the Company will no longer be at least 51 percent minority-owned and, consequently, the Company's eligibility to participate in the Section 8(a) Program will terminate. . . . After the termination of its eligibility

[1] August 25, 1983 Prospectus at 3.

[2] Prospectus at 21. The Prospectus indicates that Mr. Mariotta held only 40 percent of Wedtech's stock prior to the sale—meaning that Wedtech was ineligible for the 8(a) program even before the stock offering.

[3] August 25, 1983 Prospectus at 4, 15, 16.

to participate in the Section 8(a) Program, the Company will be required to compete for Government contracts on the same basis as other companies.[4]

Despite SBA regulations requiring prior notification and approval for any changes in ownership or control by an 8(a) company,[5] Wedtech failed to tell the SBA of its intent to go public. SBA Deputy Regional Administrator Aubrey Rogers stated in his testimony before the Subcommittee that his office learned of Wedtech's plans through "rumor rather than a direct contact by the company as should have been the case." [6] Mr. Rogers testified that Wedtech's failure to provide the SBA with prior notice of changes in ownership was grounds for termination from the program, and stated that the New York regional SBA office reacted to the news of the offering with "substantial alarm" and "disbelief".[7]

Although Wedtech did not notify the SBA of prospective ownership changes, the SBA learned of Wedtech's plans and obtained a copy of the preliminary prospectus. On September 12, 1983, the SBA's New York district office recommended that Wedtech's 8(a) eligibility be terminated as a result of the public stock offering. Two days later, Acting District Director Mervyn Shorr explained in a letter to Mr. Mariotta that this recommendation was based upon (a) the company's admission that it was no longer eligible; (b) Mr. Mariotta's failure to maintain ownership and control of the company; and (c) the company's failure to obtain prior approval for the change in ownership and management control. Mr. Shorr's letter expressly noted that the SBA had "no record of having received from you the necessary request to make the changes." As explained below, however, Wedtech was not terminated from the 8(a) program as a result of this letter.

b. Wedtech's Efforts to Influence the SBA.—Within two months of the public stock offering, Wedtech learned that a $500 million Navy pontoon contract might be awarded under the 8(a) program. Former Wedtech Executive Vice President Mario Moreno told the Subcommittee staff that the pontoon contract provided the primary motivation for the company's efforts to stay in the 8(a) program in 1983–1984. This statement is supported by two memoranda written by former Wedtech consultant E. Robert Wallach. In a November 9, 1983, memorandum to Wedtech's top officers, Mr. Wallach stated:

> The need to continue the 8a status is predicated primarily, if not exclusively, on the potential [issuance of] a $400,000,000 contract by the U.S. Navy under the 8a program. Wedtech is a prime recipient, on a merit basis, for the award of that contract.

In a December 7, 1983, file memorandum, Mr. Wallach repeated this point:

> The problem is that if we don't qualify under an 8(a) status, we're not going to get this Causeway Contract. If we do qualify for the extension, its going to be subject to challenge. The only solution is to change ownership and give it to John, which involve[s] enormous stock obligations and considerable tax potential liability to Fred Neuberger which has been outlined extensively . . .

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[4] July 1, 1983 Preliminary Prospectus at 4, 15. *See id.* at 11, 16.

[5] 13 C.F.R. Section 124.1-1(e)(vii) (1/1/86); SBA Standard Operating Procedures (1982 Rev.) at Paragraph 105(h).

[6] Hearing Record, Part 1 at 50.

[7] Hearing Record, Part 1 at 50; *see id.* at 76 (Testimony of Mr. Rose).

In an interview with the Subcommittee staff, Mr. Moreno stated that he and Wedtech attorney Bernard Ehrlich met with then-SBA Regional Administrator Peter Neglia on numerous occasions to discuss Wedtech's efforts to meet 8(a) ownership requirements and to gain Mr. Neglia's approval of these efforts. This appears to be confirmed in part by a December 22, 1983, letter from Mr. Ehrlich to Mr. Neglia, which states:

> As you[,] more than any individual, have contributed to the survival and later success of this company, we would respectfully urge you to support our contention and again assist the company in returning and participate [sic] in the 8a Program.

Mr. Moreno stated that Wedtech also contacted then-SBA Deputy Associate Administrator Robert Saldivar through consultant Stephen Denlinger and that he understood Mr. Saldivar to have been instrumental in overcoming the skepticism of other SBA officials about Wedtech's eligibility. Mr. Saldivar ultimately signed a letter granting Wedtech a three-year 8(a) program term extension.

c. The Bridge Letter.—Each 8(a) firm is permitted to participate in the program and receive 8(a) contracts for a specified period of time, called a "Fixed Program Participation Term" (FPPT). Upon completion of its term, a company automatically "graduates" from the program and becomes ineligible for additional 8(a) contracts. As the SBA's regulations explain, no action by the SBA is required to terminate a company whose FPPT has expired:

> Upon the conclusion of the Fixed Program Participation Term granted and/or extended herein, a concern will cease to be a program participant. This cessation of program participation shall occur without the necessity of any additional action by SBA; also it shall not give rise to any rights, claims or prerogatives on behalf of the concern.[8]

Wedtech's Fixed Program Participation Term expired on October 12, 1983, less than two months after the company's public stock offering. At that time, the company had already acknowledged in its preliminary prospectus that it would become ineligible for the 8(a) program as a result of the stock offering. The final prospectus formally stated that Wedtech was no longer 51% owned by socially and economically disadvantaged individuals as required by law and regulation. In addition, the prospectus reflected the receipt of almost $6 million by the company's principal stockholders, placing their economic disadvantage in question. On October 13, 1983, Wedtech notified the SBA that (a) Mr. Mariotta owned only 26.7% of the company's stock; and (b) Wedtech's Board of Directors was no longer controlled by qualified individuals.[9]

Instead of simply letting Wedtech's FPPT expire—as Deputy Regional Administrator Aubrey Rogers acknowledged the SBA could have done [10]—the SBA issued a so-called "bridge letter" granting Wedtech a temporary program extension "to permit the proper handling" of Wedtech's termination.[11] This bridge letter was

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[8] 13 C.F.R. Section 124.1-1(f)(8) (1/1/86); SBA Standard Operation Procedures (1982 Rev.) at Paragraph 108.1(b)(8).

[9] October 13, 1983 letter from Mr. Guariglia to Mr. Wilfong; *see* October 14, 1983 letter from Mr. Guariglia to Mr. Shorr.

[10] Hearing Record, Part 1 at 55.

[11] *See* September 22, 1983 letter from Mr. Yee to Mr. Wilfong (recommending issuance of bridge letter).

signed by Mr. Saldivar on behalf of Associate Administrator Henry Wilfong on September 27, 1983. On the same day, Mr. Neglia informed the Army that the temporary extension would provide a basis for a contract award to Wedtech under the 8(a) program.[12]

SBA rules and regulations in 1983 did not expressly authorize "bridge letters"; the agency's Standard Operating Procedures have subsequently been revised to provide that such letters are "strictly prohibited".[13] In response to post-hearing questions from the Subcommittee, the General Counsel of the SBA, Robert Webber, has stated that even prior to the 1987 prohibition on bridge letters, such letters were permitted only "[w]here the SBA believed that an 8(a) firm would receive an extension to its FPPT when the extension decision was finally made." Mr. Webber concluded that "[i]f Wedtech was no longer eligible to participate in the 8(a) program, it was not eligible to receive an extension to its initial FPPT and, therefore, should not have received a 'bridge letter.' " [14]

2. WEDTECH'S STOCK TRANSACTION

a. The Structure of the Transaction.—Wedtech explored several alternatives in an effort to regain eligibility before the bridge letter expired. Wedtech's former attorney, Arthur Siskind, has told the Subcommittee staff that he first learned of Wedtech's intent "to rearrange ownership" at a November 7, 1983 meeting in New York. Mr. Siskind stated that the basic concept advanced at the meeting was to give Mr. Mariotta 50 percent of the company's stock with an option to buy or not to buy it, and that he was tasked with developing a proposal.[15] Mr. Siskind further stated that he was told that this concept had already been discussed with the SBA and tentatively approved by Regional Administrator Peter Neglia.

Mr. Siskind told the Subcommittee staff that he advanced several proposals for Wedtech's consideration. One alternative examined by the company was to grant a large number of stock options to Mr. Mariotta and to claim that these options gave him effective ownership and control of the corporation, even if not exercised. A second alternative was to transfer the stock to Mr. Mariotta, subject to forfeiture if Wedtech's earnings failed to reach a specified level. According to former Wedtech Executive Vice President Mario Moreno, each of these alternatives was designed to restore nominal ownership and control of Wedtech to Mr. Mariotta without any substantative change to the financial status and holdings of Wedtech's other principal shareholders—Mr. Neuberger and Mr. Moreno.

In December 1983, Wedtech's owners agreed to a so-called stock transfer agreement under which a substantial amount of stock would be "sold" to Mr. Mariotta on a deferred payment basis. The agreement, which was written by Mr. Siskind, provided for the transfer of record ownership and voting control over some 1.8 mil-

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[12] September 27, 1983 letter from Mr. Neglia to Mr. Bodeep.

[13] SBA Standard Operating Procedures (1987 Rev.) at Paragraph 14(m).

[14] October 9, 1987 letter from Mr. Webber to the Subcommittee (hearing Record, Part 1 at 399).

[15] Mr. Siskind's statements about the November 7, 1983 meeting are supported by a November 9, 1983 memorandum from Mr. Wallach to Wedtech's officers, which summarizes the meeting.

lion shares of Wedtech stock to Mr. Mariotta. However, no stock certificates were actually delivered to Mr. Mariotta and no fixed price was even set for the transaction. As explained in a Squadron, Ellenoff memorandum, this transfer was not intended to be permanent:

> You have indicated that it is desirable for John Mariotta ("Mariotta") to obtain a majority equity interest in Wedtech Corp. ("Wedtech") for a limited period of time. As we discussed, one way to accomplish this goal is for certain shareholders to directly transfer a portion of their Wedtech stock to Mariotta.[16]

Instead, the shares were delivered to an escrow agent—the Squadron, Ellenoff law firm. Payment was to be made by Mr. Mariotta in ten annual installments beginning two years after the date of the agreement. Each payment was to be made at the market price of the stock as of the date of the payment. On the date of the transaction, Wedtech stock was valued at approximately $20 per share, so Mr. Mariotta would have been required to pay about $3.6 million annually to consummate the transaction. The actual transfer of the stock certificates to Mr. Mariotta was to be deferred until payment was made; failure to make a payment would simply result in the return of the shares to the original owners without the payment of any penalty.[17] Mr. Mariotta remained Chairman of the Board and "Chief Executive Officer," but was replaced as President and "Chief Operating Officer" by one of the company's non-disadvantaged owners.

In short, no stock certificates were actually delivered to Mr. Mariotta, no money changed hands, no payments were due for two years, the price for the sale was not fixed, and there was no penalty for a failure to pay other than the return of the stock. Mr. Siskind, the author of the agreement, stated in an interview with the Subcommittee staff that the agreement actually provided Mr. Mariotta with nothing more than an option to buy the stock in two years: "Technically, it doesn't say he has an option to pay, but on a theoretical basis, other than the tax consequences . . . it is like an option. I refer to it as an option to buy." Mr. Siskind explained that the Wedtech principals were unwilling to enter a more definitive agreement: "We needed to make it saleable to the people involved that it would not be a fixed obligation."

Two of Wedtech's former owners who were among the "sellers" in the transaction have told the Subcommittee staff that they never intended the transfer to be permanent. Mr. Moreno told the Subcommittee staff that the intent of the transaction was that the stock "would come back" to the sellers—"We weren't going to leave the stock for ten years in the hands of [Mr. Mariotta]." Mr. Moreno stated that there was an "explicit, handshake" agreement that the "sale" would be temporary. Fred Neuberger, the former Wedtech President who was the nominal "seller" of most of the stock, confirmed the temporary nature of the so-called sale. Mr. Neuberger stated that he originally wanted it in writing that he

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[16] November 17, 1983 memorandum from "HMT/PEA" to "AMS".
[17] Stock Purchase Agreements and Escrow Agreements dated December 27, 1983.

would get the stock back, but ultimately accepted a verbal commitment from the so-called "sellers." [18]

b. Approval by the New York SBA.—On January 4, 1984, Wedtech submitted its so-called stock "sale" to SBA Regional Administrator Peter Neglia for approval. The package sent to the SBA included two stock purchase agreements, two escrow agreements, three legal memoranda and at least eighteen other documents.[19] SBA Associate Regional Administrator Edric Rose and Deputy Regional Administrator Aubrey Rogers testified that the Wedtech stock transactions were discussed with the company in general terms prior to January 4, but acknowledged that January 4 was the first time that they saw the actual documents.[20] Mr. Rose stated that the transaction raised difficult issues that were entirely new to the SBA.[21]

Nonetheless, the stock transaction was approved by the New York district and regional SBA offices within a day of Wedtech's submission. The transaction was approved by Mervyn Shorr, the SBA's Acting District Director in New York on January 4—the same day that Wedtech submitted its documentation. The very next day, on January 5, the transaction was approved in three separate memoranda signed by District Counsel David Elbaum, Mr. Rose, and Mr. Neglia.

Mr. Shorr's approval was stated in a curt, three sentence memorandum to Mr. Neglia on January 4. This memorandum states that "after review of all documents submitted" by Wedtech, Mr. Shorr was prepared to recommend that the company be granted a three-year extension of its Fixed Program Participation Term. In an interview with the Subcommittee staff, Mr. Shorr asserted that he had no recollection of the letter. Mr. Shorr claimed that decisions about Wedtech's eligibility were handled by "my boss, [Bert] Haggerty." In fact, Mr. Haggerty did not come to the New York district office until eight months later; from August 1983 to September 1984, the post of District Director was vacant.

Mr. Elbaum's memorandum approving the transaction stated that he had reviewed the Wedtech stock purchase agreements and legal opinions and "incorporate[d] all of the above [the Wedtech documents], by reference." Without any further reasoning, Mr. Elbaum concluded that the agreements were sufficient to give Mr. Mariotta ownership of the stock and a controlling interest in the Wedtech:

> After reviewing all of the above, it is my considered opinion that all of the agreements are valid, binding and enforceable and that, John Mariotta, by virtue of his ownership of approximately 53% of all of the voting stock, does, in fact, have controlling interest at this time.[22]

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[18] Mr. Neuberger and Mr. Moreno told the Subcommittee staff that Wedtech's lawyers were aware of the temporary nature of the transaction. This allegation appears to be supported by a November 17 memorandum in which Squadron, Ellenoff lawyers discussed the need to transfer ownership to Mr. Mariotta "for a limited period of time." Mr. Neuberger stated that he asked Squadron, Ellenoff if the agreement to return the stock could be put in writing, but "They said no, that would be illegal." Mr. Siskind disputed this claim, stating that he discussed with Wedtech's owners the possibility that Mr. Mariotta might not pay, but that no actual agreement not to pay was made in his presence.

[19] January 4, 1984 letter from Mr. Ehrlich to Mr. Neglia.

[20] Hearing Record, Part 1 at 62 (Testimony of Mr. Rogers); *id.* at 73 (Testimony of Mr. Rose); September 25, 1987 letter from Mr. Rose to the Subcommittee (Hearing Record, Part 1 at 410).

[21] Hearing Record, Part 1 at 73, 75.

[22] January 5, 1984 memorandum from Mr. Elbaum to Mr. Rose.

The legal opinions that Mr. Elbaum incorporated by reference in his memorandum were submitted by the law firms of Biaggi & Ehrlich and Squadron, Ellenoff. Both firms not only represented Wedtech, but were also part owners of the company. In his testimony before the Subcommittee, Mr. Rogers stated that Mr. Elbaum rejected the Biaggi & Ehrlich memorandum at a December meeting because of the firm's relationship with Wedtech:

> Mr. ROGERS. . . . I recall being at the meeting at which Mr. Elbaum was present and his saying that we simply cannot accept an opinion from Biaggi & Ehrlich standing alone, for two reasons. One, counsel for the firm; secondly, they were owners as per the stock offering.[23]

Mr. Rogers stated that he was unaware that Squadron, Ellenoff also held an interest in Wedtech, and that nobody raised the firm's representation of Wedtech as a problem.[24] Mr. Elbaum denied meeting with Mr. Rogers about Wedtech's eligibility in December, and denied that he had rejected the Biaggi & Ehrlich memorandum.[25]

Mr. Elbaum also testified that he had not researched the ownership issue because Mr. Neglia had given him a narrow question, asking only whether the agreements were "valid, binding and enforceable" [26] and gave Mr. Mariotta a controlling interest in Wedtech, not whether he actually "owned the stock":

> Mr. ELBAUM. . . . Mr. Neglia, in his statement to me [asked] does Mariotta have a controlling interest by virtue of these transactions? And if you read my opinion, I refer to a controlling interest, sir.
>
> Senator LEVIN. Not ownership?
>
> Mr. ELBAUM. I do not recall referring to ownership. No, sir.
>
> Senator LEVIN. Nor were you asked by Neglia about ownership?
>
> Mr. ELBAUM. No, sir.
>
> Senator LEVIN. But you do acknowledge that there had to be both ownership and controlling interest?
>
> Mr. ELBAUM. Yes, sir, and I—well, all right. Yeah.[27]

Later in his testimony, Mr. Elbaum acknowledged that his memorandum in fact reached a conclusion on the ownership issue.[28]

Under questioning at the Subcommittee hearing, Mr. Elbaum stood by this opinion and stated that it would not have changed if he had had more time or more facts about the transaction. For example, Mr. Elbaum testified that his opinion would not have changed if he had detected a crucial error of fact in one of the Wedtech legal opinions upon which he relied.[29] Similarly, Mr. Elbaum stated that his opinion would not have changed if he had been aware of the relationship between Wedtech and the law firms that wrote the opinions.[30] Indeed, Mr. Elbaum acknowledged that his opinion probably would not have changed no matter what evidence had been presented:

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[23] Hearing Record, Part 1 at 62.
[24] Hearing Record, Part 1 at 62–66.
[25] Hearing Record, Part 1 at 109–121.
[26] Hearing Record, Part 1 at 111.
[27] Hearing Record, Part 1 at 116.
[28] Hearing Record, Part 1 at 119.
[29] Hearing Record, Part 1 at 113.
[30] Hearing Record, Part 1 at 120.

Senator LEVIN. I think it is pretty obvious nothing would have changed anything. Your opinion was going to be written the way it was, regardless of a whole lot of things.

Mr. ELBAUM. Yeah.[31]

Mr. Elbaum drafted his memorandum under severe time pressure from Regional Administrator Peter Neglia. In his testimony before the Subcommittee, Mr. Elbaum stated that he was called to Mr. Neglia's office on January 3 or 4 and told to provide a legal opinion on the validity of the stock transaction as quickly as possible:

Mr. ELBAUM. . . . Mr. Neglia informed me that time was of the essence because there was a conference of some kind in Washington with regard to a contract that was to be awarded to Wedtech. . . .

This is what I was told. That there was a conference supposedly occurring in Washington on or about that time, on the 4th or on the 5th, and that it had to do with a contract, and that until the issue with regard to the controlling interest of Mariotta was determined, they could not move, and therefore I had to render a "fast" opinion, if you will.[32]

Mr. Elbaum stated that this was the first time that the issue of Wedtech's stock transaction and continuing eligibility had been brought to his attention.[33]

Deputy Regional Administrator Aubrey Rogers and Associate Regional Administrator Edric Rose testified that the regional office approved the transaction in reliance upon Mr. Elbaum's opinion [34] without seeking the advice of its own Regional SBA Counsel, Jack Matthews. Mr. Rogers and Mr. Rose stated that they did not ask Mr. Matthews for an opinion because (a) he was not in the office at the time; and (b) the normal practice of the office was for Regional Administrator Peter Neglia to seek counsel's opinion himself.[35] Mr. Elbaum acknowledged that as District Counsel, he ordinarily rendered opinions to the District Director and not to the Regional Administrator; Mr. Neglia "very rarely" asked him for a legal opinion on any issue.[36]

Mr. Matthews disputed the testimony of Mr. Rogers and Mr. Rose, testifying that the issue should have been, and normally would have been, referred to him. Mr. Matthews explained that "at that time, there was a policy . . . that any 8(a) matter that came to the regional office . . . had to be reviewed by legal." [37] Moreover, the practice of the office was for Mr. Rose to send documents to him for review:

Mr. MATTHEWS. As a practical matter, what happens, and maybe Mr. Ros[illegible]lated this, he would write a letter of recommendation for his signature, and he w[illegible]d prepare a letter of recommendation for the Regional Administrator on this or any other similar subject. He would then send the package to my office for legal review.[38]

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[31] Hearing Record, Part 1 at 120.
[32] Hearing Record, Part 1 at 110, 111.
[33] Hearing Record, Part 1 at 109–10. Mr. Elbaum's testimony directly contradicts that of Mr. Rogers on this point. *See id.* at 61–62 (Testimony of Mr. Rogers).
[34] Hearing Record, Part 1 at 66 (Testimony of Mr. Rogers); *id.* at 209 (Prepared Statement of Mr. Rose). See January 5, 1984 memorandum from Mr. Rose to Mr. Neglia.
[35] Hearing Record, Part 1 at 61 (Testimony of Mr. Rogers); *id.* at 73–74 (Testimony of Mr. Rose).
[36] Hearing Record, Part 1 at 123.
[37] Hearing Record, Part 1 at 103, 105.
[38] Hearing Record, Part 1 at 105.

Moreover, Mr. Matthews stated that he had checked his payroll and travel records and ascertained that he had not been out of the office at all in the last week of December 1983 or the first week of January 1984.[39] Even if he had been out of the office, Mr. Matthews stated, the normal practice would have been for Mr. Rose to send the package to his deputy, Joseph Hallock.[40] This was not done either.

Mr. Matthews indicated that if the transaction had been presented to him, he might not have approved it. First, Mr. Matthews testified that he took the position in the fall of 1983 that Wedtech was no longer qualified for the 8(a) program because (a) the company failed to notify the SBA of the public stock offering; (b) the company appeared not to be owned and controlled by qualified individuals; and possibly (c) the company had lost its economically disadvantaged status.[41] Second, Mr. Matthews testified that he was "surprised" and "suspicious" when he learned—some time in February—that the transaction had taken place and been approved without his participation:

> Senator COHEN. Could you tell us what you thought about the situation when you were out of town and you came back and the decision had been made without going through you? What were your feelings at the time?
>
> Mr. MATTHEWS. Well I learned about it, as I think I put in my written statement, sometime in February. . . . I knew what the issue was prior to that time and I was surprised, to say the least, without going into great details of it.
>
> Senator COHEN. Why were you surprised?
>
> Mr. MATTHEWS. I had a gut feeling that, as I say, without reviewing the documents or doing any legal research, or preparing any formal opinion, that it looked kind of crazy.[42]

c. Approval by the National SBA.—Wedtech was the first 8(a) company ever to go public and attempt to remain in the program. Because of the precedent-setting nature of the issue, Wedtech's continued 8(a) eligibility received attention at the highest levels of the SBA. As former SBA Administrator James Sanders explained in his testimony before the Subcommittee, the SBA decided as a matter of policy to permit public companies to remain in the program:

> Mr. SANDERS. That was a policy decision that was made. It was a breakthrough. It was new ground. It was considered. I have a recollection that we considered it would be unfair to a company as a general rule not to let it go public.
>
> . . . It seems apparent, and it was our policy, that if a company succeeds, having started in the 8(a) program, it will at one point in time no longer be economically disadvantaged. You simply do not throw it out of the program at that time. . . . So following along on that same line, it seemed at that time—and I am not so sure I would make the same decision now—that to prevent a company from going for public issues of stock would not be fair to the development of that firm.[43]

In an interview with the Subcommittee staff, Mr. Sanders' former Chief of Staff, Robert Luhlier, expressed a different opinion. Unlike Mr. Sanders, Mr. Luhlier stated that when a company goes public, it has probably reached the point where it no longer needs the 8(a) program and should be required to compete on its own. Mr. Luhlier explained that, in his experience, 8(a) companies have gone

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[39] Hearing Record, Part 1 at 105.
[40] Hearing Record, Part 1 at 105.
[41] Hearing Record, Part 1 at 104, 106.
[42] Hearing Record, Part 1 at 103–104.
[43] Hearing Record, Part 1 at 128–29.

public to "cash out", or reap huge cash benefits. Mr. Luhlier said that he could see little reason for the SBA to provide active assistance to a company whose owners want "to go public and become millionaires."

Mr. Sanders testified that he addressed the issue of public companies only as a matter of policy, and did not address the specific details of the Wedtech case. In an interview with the Subcommittee staff, Mr. Sanders stated that he was aware that the company would have to develop some mechanism to maintain control by disadvantaged individuals after it went public, but that he left the details up to his General Counsel, Robert Webber. Mr. Sanders confirmed this statement in his testimony before the Subcommittee:

> Mr. SANDERS. I did not inject myself into the mechanisms by which we could accomplish the qualification of the minority owner. . . . I left that up to, obviously, counsel.[44]

Mr. Webber's direct involvement in the approval of Wedtech's stock transaction was confirmed by both Deputy Regional Administrator Aubrey Rogers and Mr. Sanders' former Chief of Staff, Robert Luhlier. In response to post-hearing questions from the Subcommittee, Mr. Rogers stated that he personally discussed Wedtech's eligibility with Mr. Webber in January 1984:

> I discussed the issue with General Counsel Robert Webber in January, 1984. . . . General Counsel Robert Webber was skeptical about the matter and voiced concern about keeping a firm in the 8(a) program whose owners were multi-millionaires. He said that he would study the issue.[45]

In an interview with the Subcommittee staff, Mr. Luhlier, too, said that he personally consulted with Mr. Webber about the validity of both the public stock offering and the Wedtech stock transaction. In late 1983, Mr. Luhlier reported, he got a call from Mr. Neglia, who told him that Wedtech wanted to go public and asked how the Administrator would view this. After a preliminary conversation with Mr. Webber, Mr. Luhlier stated, he told Mr. Neglia that any arrangement entered by Wedtech would have to be cleared with the General Counsel—"When it gets down there if you haven't documented the thing and gotten the General Counsel to agree with you then it is not going to happen." Some weeks later, Wedtech's submittal arrived in Mr. Luhlier's office "in a binder about the size of the Manhattan phone book." Mr. Luhlier stated that he had this package taken down to the General Counsel "to have them review it and make a recommendation to the Administrator. They did and they told the Administrator that the way they had it structured, it would not be a problem and they could go forward."

On January 30, 1984, Mr. Webber signed a written opinion in which he outlined and approved the Wedtech stock transaction. Mr. Webber's opinion letter stated that he had reviewed a file—presumably the file referred to by Mr. Luhlier—including the Wedtech prospectus, legal opinions, stock purchase agreements, and other documents. The opinion letter noted that "a critical percentage of Mr. Mariotta's stock is subject to deferred payment" at a

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[44] Hearing Record, Part 1 at 144–45.

[45] October 15, 1987 letter from Mr. Rogers to the Subcommittee (hearing Record, Part 1 at 406).

price "to be determined at dates the payments are due" and accordingly "is held in escrow against this payment." Nonetheless, the letter concluded that the transaction was effective to convey ownership to Mr. Mariotta and that "Wedtech corporation now meets the standards of 8(a) program eligibility." [46]

In his testimony before the Subcommittee, Mr. Webber stated that he signed the memorandum "in a fairly routine fashion" in reliance upon his staff. Mr. Webber testified that he now believes that the opinion reached the wrong decision, but that there was no way he could have known this at the time he signed it, because he did not personally review the file.[47] Thus, Mr. Webber claimed that he was unaware that the stock was to be paid for over a ten-year period, that no payments were to be made for two years, that no price was to be set until the payments were due, or that the stock would simply revert to its original owners if no payment was made.[48]

This testimony appears inconsistent with the statements of Mr. Sanders, Mr. Luhlier, and Mr. Rogers that Mr. Webber actively participated in meetings and discussions on the issue. Mr. Webber himself did not deny his participation in these meetings:

Mr. WEBBER. I have no recollection of the meetings, Mr. Chairman. I would not question the fact that there were meetings held at that time, but my recollection is very dim. . . .[49]

Charlie Dean—the SBA attorney who worked on the opinion for Mr. Webber—has told the Subcommittee staff that he "knew it was important" and is sure he would have discussed it with Mr. Webber.

Mr. Webber acknowledged in his testimony that the Wedtech eligibility decision was not just another opinion letter, but an important issue of first impression:

Senator LEVIN. Wouldn't you agree this was not just some routine case? This was the first public sale——

Mr. WEBBER. I would certainly agree, sir.

Senator LEVIN. This was not one of 500 pieces of paper on routine cases. This was the number one, first time that there had ever been a public sale by an 8(a) company. And by the way, had you ever seen a transfer like this before?

Mr. WEBBER. No.

Senator LEVIN. So this was not just an everyday transaction, was it?

Mr. WEBBER. No, it was not.[50]

Mr. Webber concluded that he would not approve the transaction today, knowing what he knows now:

Mr. WEBBER. . . . [T]he facts were not clearly expressed, the issues were not stated, the legal analysis was not there, and the opinion is not a good opinion in itself. It should not have been signed.[51]

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[46] January 30, 1984 memorandum from Mr. Webber to Mr. Luhlier. Mr. Webber testified that this memorandum subsequently disappeared from the files of his office. Hearing Record, Part 1 at 97. Former Wedtech Executive Vice President Mario Moreno has told the Subcommittee staff that Wedtech consultant Bernard Ehrlich showed him the original memorandum, with Mr. Webber's signature, in late 1986.

[47] Hearing Record, Part 1 at 97, 99.

[48] Hearing Record, Part 1 at 97, 98–99, 101.

[49] Hearing Record, Part 1 at 97.

[50] Hearing Record, Part 1 at 100.

[51] Hearing Record at 99–100; *see id.* at 102.

3. THE ECONOMIC DISADVANTAGE ISSUE

a. The Effects of the Stock Offering.—Participation in the 8(a) program is limited to firms that are owned and controlled by "economically disadvantaged" individuals. Under SBA regulations, "economically disadvantaged" individuals are those whose ability to compete "has been impaired due to diminished capital and credit opportunities." In determining whether an individual is economically disadvantaged, the SBA is required to consider the individual's personal business assets, net worth, income and profits, as well as the availability of financing, bonding, and outside equity capital to the applicant firm.[52]

Wedtech's public stock offering placed the "economically disadvantaged" status of the firm and its owners in grave doubt. The company raised almost $22 million through the offering and an additional $20 million through a new line of credit,[53] demonstrating substantial access to outside financing and equity capital. The prospectus for the offering indicated that more than $10 million of the proceeds would be used to establish an entirely new line of business. Of the remaining funds, approximately $5 million was to be used to retire existing debts and pay bills, and $4 million was to be added to working capital.[54]

At the same time, the company's owners suddenly became multimillionaires. Wedtech's prospectus reflects $6 million of stock sales by the company's three principal stockholders, including almost $3 million in sales by Mr. Mariotta.[55] A Personal Financial Statement that Mr. Mariotta filed with the SBA three months after the stock offering showed more than a million dollars in liquid assets.[56] This did not even include the 1.5 million shares of Wedtech stock that Mr. Mariotta held even before the January stock transaction—which had a market value of more than $30 million at the January 4, 1984, selling price of $20 dollars a share.[57]

Wedtech claimed that it still qualified as economically disadvantaged despite the wealth of its owners, because it competed "in a national market" against huge defense contractors such as General Dynamics, Rockwell, United Technologies, and Lockheed. As the company explained in a memorandum submitted to the SBA on December 12, 1983, it was still economically disadvantaged by comparison to these companies:

> Wedtech competes in a national market against such giants as General Dynamics, Rockwell, United Technology, and Lockheed. . . . Sales and net income information for the last twelve months is indicative of how small Wedtech's market share is in comparison to its competitors.
>
> Sales information for the twelve months ending 6/30/83:

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[52] 13 C.F.R. Section 124.1-1(e)(4) (1/1/81).

[53] February 21, 1984, memorandum from Mr. Wallach to Wedtech files.

[54] August 25, 1983 Prospectus at 6-7.

[55] August 25, 1983 Prospectus at 3, 21.

[56] Mr. Mariotta showed a net worth of only $610,000 (not including his Wedtech stock), because he counted a $550,000 loan payable by Wedtech as a liability on the ground that it was secured by his personal holdings.

[57] January 5, 1984 New York Times at D18 (Over-The-Counter Quotations). This does not include the 1.9 million shares included in the sham stock transaction—as explained above, Mr. Mariotta had not yet paid for these shares and had no intention of doing so.

	Sales
Grumman Corp	$2,078,098,000
Rockwell	7,828,900,000
Teledyne, Inc	2,861,600,000
Lockheed	6,282,200,000
FMC Corp	3,481,392,000
General Dynamics	6,983,200,000
United Technology	14,098,902,000
Wedtech	20,491,556

Wedtech's competitors have access to large financial resources. Moreover, some of Wedtech's competitors can borrow at the prime rate. . . . This gives Wedtech's competitors economic advantage in that they are able to bid lower on contracts due to the availability of less expensive financing. Indeed, without the SBA's assistance Wedtech would be unable to compete; therefore, Wedtech is economically disadvantaged . . .

In addition, the company contended that Mr. Mariotta remained economically disadvantaged despite his "substantial holdings in Wedtech." In a December 20, 1983, memorandum, the company asserted that the value of Wedtech stock should not be considered in determining Mr. Mariotta's net worth—despite SBA regulations requiring the evaluation of business assets [58]—because these assets were "illiquid":

The mere fact that John Mariotta has substantial holdings in Wedtech does not change the fact that John Mariotta remains economically disadvantaged within the meaning of the 8(a) program. . . .

John Mariotta's personal assets classify him as economically disadvantaged. Mr. Mariotta's assets are illiquid. His principal asset is Wedtech stock which, at present, is regarded by financial institutions as volatile. Recently Wedtech went public, and the market for it's [sic] shares has not had the opportunity to stabilize. Hence, Mr. Mariotta is illiquid, and significantly, this factor indicates that Mr. Mariotta's wealth may be overestimated.

The December 20 memorandum incorrectly (a) stated that Wedtech had recently lost an Army contract "because it was believed that Wedtech could not finance the project"; and (b) implied that Mr. Mariotta's assets were the company's sole source of financing for capital expansion. In fact, Wedtech lost the contract because it was not the low bidder, and the company had already demonstrated substantial access to other sources of capital and loans.

b. The SBA's Approval.—On January 5, 1984, Mr. Rose accepted Wedtech's arguments and concluded that the company remained economically disadvantaged. In a memorandum to Mr. Neglia, Mr. Rose explained that he had disregarded Mr. Mariotta's stock holdings and substantial net worth because (a) the stock was "not possible to value"; and (b) Wedtech needed large sums of money to continue to compete against "fortune 500 firms":

SEC regulation[s] provide that none of the officers of the corporation can trade their stock on the market at this time. Thus it is not possible to value their shares using the current market value of same. Further, the present condition of the 8(a) firm with its 95 percent dependence on 8(a) contracts and fact [sic] that its competitors are all fortune 500 firms, makes it difficult to estimate the value of the said shares using other factors such [as] a relevant percentage of the net worth of the firm.

Wedtech Corporation requires large sums of money to maintain an adequate cash flow while performing the types of contracts it is engaged in. The strong financial status of the principals is necessary if financial institutions, which normally view high technology and minority companies as high risks, are to provide financial support to this firm.

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[58] 13 C.F.R. Section 124.1-1(c)(4)(ii)(A)(1) (1/1/86).

Mr. Rose's January 5, memorandum was full of errors of fact and law. Contrary to Mr. Rose's assertion in the memorandum, for example, SEC regulations did not prohibit Wedtech's officers from trading their stock on the market. SEC Rule 144, which limits trades of unregistered stock such as that held by Wedtech's officers, merely prohibits the sale of more than 1 percent of the total outstanding stock in a company by any one individual in a single ninety-day period.[59] As of January 4, 1984, one percent of Wedtech's stock was worth approximately $1.2 million.[60]

Mr. Rose testified that he concluded that Wedtech officers could not sell their stock because that we was what he was told by the company and its attorneys.[61] In fact, however, even Wedtech did not represent that stock sales were impossible, only that they were limited. The prospectus for Wedtech's stock sale expressly stated that "present shareholders of the Company will be entitled to sell all of their present holdings of Common Stock to the public subject to compliance with Rule 144 under the Act." The prospectus further explained that Rule 144 permits shareholders to sell "within any three-month period a number of shares that does not exceed . . . 1% of the total number of outstanding shares of Common Stock." [62] Wedtech attorney Bernard Ehrlich reconfirmed this point, though slightly misstating the law, in a December 22, 1983 letter to the SBA.[63]

In his prepared testimony for the Subcommittee, Mr. Rose contended that Mr. Mariotta's stock could not be valued at the quoted price because "any large blocks of stock offered on the market at any given period . . . would have had a very negative impact on the price of the stock." [64] In fact, however, SEC records show that more than 800,000 shares of Wedtech stock were traded in the ninety days immediately preceding Mr. Rose's decision without depressing the price. Over the two-year period when Mr. Rose claimed that Wedtech officials would be prohibited to sell stock, Mr. Mariotta in fact realized more than $1.5 million in stock sales.

Mr. Rose's conclusion in the January 5 memorandum that Wedtech's competitors were "fortune 500 firms" was also incorrect. In his testimony before the Subcommittee, Mr. Rose stated that he based this conclusion upon (a) comparative data published by Dun & Bradstreet and Robert Morris Associates and (b) his knowledge of Wedtech's competitors in the engine business.[65] In response to post-hearing questions from the Subcommittee, however, Mr. Rose corrected his earlier statement by acknowledging that he was not aware that either Dun & Bradstreet or Robert Morris published data comparing firms in the market for specific products.[66] Mr.

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[59] 17 C.F.R. Section 230.144.

[60] Wedtech had more than 5.8 million shares outstanding (Prospectus at 3) at a value of approximately $20 per share (January 5, 1984 New York Times at D18).

[61] Hearing Record, Part 1, at 83.

[62] August 25, 1983 Prospectus at 22.

[63] Mr. Ehrlich's letter incorrectly stated that Mr. Mariotta was limited to selling one percent of "his current holdings"—as opposed to the total outstanding stock of the corporation—every 90 days.

[64] Hearing Record, Part 1 at 210.

[65] Hearing Record, Part 1 at 77-78.

[66] September 25, 1987 letter from Mr. Rose to the Subcommittee (Hearing Record, Part 1 at 410).

Rose stated that the data he relied upon was general data on firms in the defense industry; he had to make the assumption that these firms were actually Wedtech competitors.

Moreover, Mr. Rose testified that he did not know and did not attempt to determine who Wedtech's actual competitors in the engine business were.[67] Wedtech bid competitively on two engine contracts in 1983 and 1984; its competitors for these contracts were Clinton Engine Company, Garcia Ordnance Corporation, Duroyd Manufacturing Company, TWA Mold Company, and WF Industries. All of these except WF Industries were small businesses. Avco Corporation, the Fortune 500 company mentioned by Mr. Rose in his testimony as a possible Wedtech competitor in the engine business,[68] did not bid on either contract.

Finally, Mr. Rose's statement in the January 5 memorandum that Wedtech needed existing sources of money "to maintain an adequate cash flow while performing the types of contracts it is engaged in" was inconsistent with Wedtech's own statements at the time. Mr. Rose testified that he "assumed" that the proceeds of Wedtech's public stock offering would go to existing lines of business.[69] However, the prospectus for the offering stated that more than half of these funds was to be devoted to the development of an entirely new business related on a "coating process."[70] Wedtech reaffirmed this point in an October 13, 1983 letter to the SBA, a copy of which went to Mr. Rose. The October 13 letter expressly stated that proceeds from the stock sale would not be used for cash flow on existing business:

> The only cash flow generated by the operations of Wedtech Corp. to finance the production of the contracts is progress payments received form the Federal Government. . . . Although Wedtech Corp. raised $22,260,000 from an initial public [stock] offering . . . the proceeds were used for the repayment of certain indebtedness with the remainder earmarked for certain plant expansion and equipment acquisitions.[71]

In his testimony before the Subcommittee and in an interview with the Subcommittee staff, Mr. Rose indicated that he still believes that an individual with a million dollars of cash in the bank, who owns a company with access to millions of dollars in capital and credit, can qualify as economically disadvantaged.[72] Other current SBA officials have expressed similar views to the Subcommittee staff.

c. Wedtech's 8(a) Term Extension.—SBA Regulations authorize the SBA to grant extensions of Fixed Program Participation Terms in certain limited circumstances.[73] As former SBA Administrator James Sanders explained in an interview with the Subcommittee staff, the SBA was "supposed to be tough" in judging whether an FPPT extension was necessary. Mr. Sanders stated that, in his view, extensions were to be granted only in "extraordinary" cir-

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[67] Hearing Record, Part 1 at 77-78.
[68] Hearing Record, Part 1 at 77.
[69] Hearing Record, Part 1 at 78-79.
[70] August 25, 1983 Prospectus at 6-7.
[71] October 13, 1983 letter from Mr. Guariglia to Mr. Rogers.
[72] Hearing Record, Part 1 at 80-82.
[73] C.F.R. 124.1-1(f)(5) (1/1/86).

cumstances—"something like an arithmetic mistake." Otherwise, "you would have all of them in for an extension." [74]

In particular, SBA regulations stated that substantial 8(a) awards to a firm, substantial SBA grants and loans to the firm, failure by the firm to decrease its reliance upon 8(a) contracts, failure to increase the importance of non-8(a) contracts, and long-term participation in the program, were all "significant factor[s] toward limiting" Fixed Program Participation Terms.[75] In late 1983 and early 1984, each of these factors cut against an extension for Wedtech. Wedtech had already received more than $50 million in 8(a) contracts, more than $3 million in SBA grants, and more than $8 million in SBA loans. Moreover, the company had been in the 8(a) program for seven years and remained 95% dependent upon 8(a) contracts.

Without considering any of these factors, Mr. Rose's January 5, 1984, memorandum to Mr. Neglia concluded that Wedtech should be granted a three-year extension. This recommendation was endorsed the same day in a memorandum from Mr. Neglia to Associate Administrator Henry Wilfong in the SBA's Washington Office.[76] Three weeks later, Deputy Associate Administrator Robert Saldivar signed a letter on behalf of Mr. Wilfong in which he granted the requested extension.[77] The letter extending Wedtech's eligibility to receive 8(a) contracts was written on January 25, 1984—the very same day that the SBA's Washington office presented Wedtech to the Navy as the SBA's candidate for the Navy pontoon contract.[78]

4. DISCUSSION AND FINDINGS

a. The Bridge Letter.—When Wedtech went public in August 1983, it appears to have lost its 8(a) eligibility. The prospectus for Wedtech's stock offering stated that the company was only 26.7% owned by disadvantaged individuals, instead of the 51% required by the Small Business Act and SBA regulations. The preliminary prospectus went even further, expressly acknowledging that the company was no longer eligible for the 8(a) program. Just one month later, on October 12, 1983, Wedtech's 8(a) program term expired and without further action from the SBA the company would have automatically left the program. Despite Wedtech's lack of eligibility, SBA officials issued a "bridge letter" on September 27, 1983, giving the company a temporary extension to its 8(a) program term.

The SBA's policy in 1983 was to issue bridge letters only to companies that were thought to be eligible for extensions. Under these terms, Wedtech clearly did not qualify for a bridge letter: the company was no longer owned by disadvantaged individuals and had

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[74] Mr. Sanders confirmed this position in his testimony before the Subcommittee. *See* Hearing Record, Part 1 at 146.

[75] 13 C.F.R. Section 124.1-1(f)(5) (1/1/86).

[76] The Subcommittee has discovered two different versions of Mr. Neglia's letter—one dated January 5 and one dated January 11. A later memorandum, prepared in the General Counsel's office, makes reference to the January 5 version.

[77] January 25, 1984 letter from Mr. Saldivar to Mr. Mariotta. In an interview with the Subcommittee staff, Mr. Saldivar stated that the extension was virtually automatic once the SBA determined that Wedtech remained eligible for the program.

[78] Synopsis of 25 January 1984 Briefing at SBA.

gone so far as to admit its lack of eligibility in an official document filed with the Securities and Exchange Commission and subsequently obtained by the SBA. For this reason, Wedtech's bridge letter was anything but routine—it was issued in violation of SBA policy to a company that SBA officials knew, by Wedtech's own admission, to be ineligible for the program.

The Subcommittee finds that the SBA improperly gave Wedtech a temporary 8(a) extension in September 1983, at a time when the company, by its own admission, was no longer owned by disadvantaged individuals as a result of its public stock offering.

b. The Sham Stock Transaction.—In early January 1984, Wedtech officials entered a so-called stock purchase agreement for the express purpose of convincing the SBA to allow the company to remain in the 8(a) program. On January 5, 1984, SBA officials approved this transaction, despite having reviewed documents indicating that no stock had been delivered to the purchaser, no money had changed hands, no payments were due for two years, the price for the sale was not fixed, and failure to pay would result only in the return of the stock to its original owners without the payment of any penalty.

Under the terms of the agreement, it is highly unlikely that Mr. Mariotta could ever have paid for the stock. The agreement required Mr. Mariotta to pay $3.6 million every year for ten years to complete the purchase. If Mr. Mariotta was capable of making these payments, he could not possibly have been "economically disadvantaged". If, as appears more likely, he was incapable of making the payments, there was no possibility that he would ever actually own a majority of the stock outright. Either way, Wedtech should have lost its eligibility for the 8(a) program.

In short, Wedtech's 8(a) certified disadvantaged owner, Mr. Mariotta, did not put up any money for the stock, he would not benefit from any increase in the value in the stock, and it was highly unlikely that he would ever own the stock. If this arrangement constituted "ownership" for 8(a) purposes, virtually any non-disadvantaged small business could qualify for the program—without sacrificing anything more than temporary voting control—through a similar arrangement with a qualified disadvantaged individual.

For these reasons, the Subcommittee finds that the stock transaction entered into by Wedtech's owners in January 1984 was a sham that did not convey ownership and control of the company to Mr. Mariotta and never should have been approved by the SBA.

SBA officials who approved the Wedtech stock transaction state that they made this decision in a routine and objective manner without any bias or favoritism toward Wedtech. Mr. Elbaum, the SBA's District Counsel in New York, testified that he believed that Wedtech's stock purchase and escrow agreements were effective to transfer ownership and control of the stock to Mr. Mariotta. Mr. Rose and Mr. Rogers, two top officials in the SBA's New York regional office, testified that they approved the transaction on the basis of Mr. Elbaum's recommendation. And Mr. Webber, the SBA's General Counsel, testified that he routinely signed a memorandum approving the transaction without any awareness of the details.

The circumstances of the approval and inconsistencies in the testimony and statements of SBA officials at both the local and national level call these explanations into question.

First, at the local level, the testimony of Mr. Elbaum, Mr. Rose and Mr. Rogers that their decisions were routine and objective is contradicted by the following facts:

(1) The transaction was approved with unreasonable haste, going through four levels of sign-offs in a period of just two days despite the novel and complex issues presented.

(2) The SBA's Acting District Director, Mervyn Shorr, denied any participation in the approval, despite the fact that he personally signed a letter—without even waiting for an opinion from his own District Counsel—stating that he had reviewed "all documents submitted" and believed that Wedtech remained eligible.

(3) The District Counsel, David Elbaum, met directly with the Regional Administrator and submitted his opinion to the regional office, rather than to his own district office, as was the usual practice.

(4) Mr. Elbaum testified that he was directed by the Regional Administrator to complete his review as quickly as possible because of "a conference of some kind in Washington" about "a contract that was to be awarded to Wedtech".

(5) Mr. Elbaum incorporated a Wedtech opinion letter by reference in his own memorandum without noting an obvious and crucial error of fact in the Wedtech opinion.

(6) The SBA rejected an opinion letter written by one law firm on the ground that the firm regularly represented Wedtech and owned stock in the company, then proceeded to accept an opinion letter from a second law firm that also represented Wedtech and owned stock in the company.

(7) Mr. Elbaum and SBA Deputy Regional Administrator Aubrey Rogers gave conflicting testimony under oath as to whether Mr. Elbaum attended and actively participated in meetings about Wedtech's eligibility in December 1983.

(8) The SBA's Regional Counsel, Jack Matthews, who had expressed doubt about Wedtech's eligibility in earlier meetings, was not consulted on the validity of the transaction.

(9) Two SBA regional officials testified that they did not consult Mr. Matthews because it was not their usual practice to do so, but Mr. Matthews testified that under the policy and practice of the office all 8(a) matters were brought to him for approval.

(10) The same two regional officials testified that Mr. Matthews was out of town when the issue came up, but Mr. Matthews denied this and stated that even if he had been out of town the issue should have been brought up with his deputy (which it was not).

For these reasons, the Subcommittee finds that the Wedtech stock transaction was approved by SBA officials at the local level with unreasonable haste, outside normal decision-making channels, and with complete disregard to obvious facts. The fact that this process resulted in the approval of an obvious sham transaction raises a serious question whether SBA officials intentionally bent eligibility rules for the purpose of assisting a well-connected and favored company.

Second, at the national level, SBA General Counsel Robert Webber testified that his office's review of the Wedtech stock transaction was sloppy, failed to address important facts and analyze key legal issues, and reached the wrong conclusion. Mr. Webber further testified that he did not personally familiarize himself with the Wedtech transaction, despite his awareness that Wedtech was the first 8(a) company to go public, making the company's continued eligibility a high visibility issue with far-reaching implications. At the very least, this testimony reveals a serious failure by the General Counsel and his office to come to grips with an important issue.

Moreover, the statements of several other witness raise questions about Mr. Webber's testimony that he was not personally aware of the details of the Wedtech transaction. In particular:

(1) The former Administrator of the SBA, James Sanders, testified that he viewed the Wedtech eligibility decision as an important one and entrusted the details to Mr. Webber.

(2) Mr. Sanders' Chief of Staff, Bob Luhlier, stated that he personally discussed the issue with Mr. Webber on several occasions and requested that Mr. Webber review the transaction.

(3) The Deputy Regional Administrator, Aubrey Rogers, testified that he personally discussed the issue with Mr. Webber and that Mr. Webber expressed concern about Wedtech's continuing eligibility.

(4) The SBA attorney who drafted the opinion memorandum issued by the General Counsel's office stated that he knew the decision was an important one and would not have written the opinion without Mr. Webber's approval.

If, as these statements seem to indicate, Mr. Webber was familiar with the details of the Wedtech transaction, the failure of his office adequately to address the issues raised may be indicative not of negligence, but of conscious favoritism.

For these reasons, the Subcommittee finds that the Wedtech stock transaction was approved by SBA officials at the national level after a superficial review that indicates at a minimum a serious lack of diligence and possibly conscious favoritism for a well-connected company. The Subcommittee further finds that the testimony of SBA officials at both the local and the national level regarding their approval of Wedtech's stock transaction is implausible and insufficient to explain known facts.

c. The Economic Disadvantage Issue.—With the success of its public stock offering, Wedtech also appears to have overcome its "economically disadvantaged" status. In a period of less than one year, from August 1983 to May 1984, Wedtech completed a $27 million public stock offering, a $40 million stock debenture offering, and raised an additional $20 million through a new line of credit. Over the next two years, the company became so large that it spun off several divisions, absorbed two smaller companies, and purchased numerous properties in the New York area.

At the same time, Wedtech's owners became instant multi-millionaires. Mr. Mariotta, the supposedly disadvantaged individual upon whom Wedtech based its eligibility, received almost three million dollars from the proceeds of the company's August 1983 public stock offering. In a December 1983 financial disclosure form,

Mr. Mariotta reported liquid assets worth more than a million dollars—not including his Wedtech stock, which had a market value of approximately $30 million. SBA officials acknowledge that they were astounded by Mr. Mariotta's wealth when they reviewed his financial disclosure forms; as Deputy Regional Administrator Aubrey Rogers put it, "we had never met anyone with a million bucks before."

Despite the immense personal and business wealth of Wedtech's owners, Mr. Rose concluded in a January 5, 1984, memorandum that Wedtech and its owners remained economically disadvantaged. This conclusion is incredible on its face. Moreover, Mr. Rose's memorandum of January 5 was premised upon a series of factual and legal errors:

(1) The memorandum stated that Mr. Mariotta's stock could not be valued because he was legally prohibited from selling it. This was not true. SEC regulations precluded Mr. Mariotta only from selling more than a million dollars worth of stock every ninety days.

(2) Mr. Rose testified that he did not believe Mr. Mariotta could sell his stock because that is what he was told by Wedtech and its attorneys. In fact, Wedtech's lawyers told the SBA in writing that stock sales were limited, not prohibited.

(3) Mr. Rose testified that Mr. Mariotta's stock could not be valued, because any substantial sale of Wedtech stock would have depressed the price. In fact, more than $16 million of Wedtech stock was sold in the ninety days prior to the SBA decision, and the price of the stock rose in value.

(4) The memorandum stated that Wedtech's competitors were all "fortune 500 companies". This was not true. In fact, virtually all of Wedtech's competitors for engine contracts were small businesses.

(5) Mr. Rose testified that he believed Wedtech's competitors to be "fortune 500" companies on the basis of comparative data published by Dun & Bradstreet. In fact, Dun & Bradstreet publishes no data comparing firms in the market for specific products.

(6) The memorandum stated that Wedtech needed all existing sources of funds to maintain an adequate cash flow in existing lines of business. In fact, Wedtech informed the SBA in writing that it was devoting large sums of money to purchasing other companies and establishing new lines of business.

Later developments add further doubt to the objectivity and validity of the SBA's conclusion that Wedtech was economically disadvantaged. The SBA allowed Wedtech to remain in the 8(a) program even after the company raised $40 million through an offering of stock debentures in May 1984, after it raised $30 million through an increased line of credit in 1985, and after it raised another $16 million through a third public stock offering in January 1986. The SBA still maintained that Wedtech was economically disadvantaged even when it received new financial disclosure forms in 1984 and 1985 indicating that the net worth of Wedtech's owners continued to increase, when the price of Wedtech's stock proved stable over a period of years, and when Wedtech's owners sold millions of dollars worth of stock.

In short, the SBA concluded that Wedtech and its owners remained economically disadvantaged in spite of the facts and not be-

cause of them. The SBA continued uncritically to allow the company to remain in the 8(a) program at a time when it was clearly ineligible. These decisions should never have been made. *The Subcommittee finds that the SBA ignored the facts in determining that Wedtech's owners were economically disadvantaged when they were multi-millionaires and had proven access to millions of dollars in capital and loans.*

d. Wedtech's Fixed Program Term.—At the same time that the SBA approved Wedtech's sham stock transaction and found that the company remained economically disadvantaged, the agency granted Wedtech a three-year extension of its 8(a) program term. The SBA officials who made this decision—Mr. Shorr at the District level, Mr. Rose at the Regional level, and Mr. Saldivar at the national level—have told the Subcommittee that it was routine: once it was determined that an 8(a) company remained eligible for the program, it was a foregone conclusion that it would receive the extension.

SBA officials granted Wedtech a three-year extension of its 8(a) program term without completing objective evaluation forms required by the agency's Standard Operating Procedures, and without an evaluation of the factors set forth in those procedures as the basis for evaluating extension requests. These factors, if considered, would have precluded an extension for Wedtech, which had already been in the 8(a) program for years, received substantial contract awards, grants and loans, and remained 95% dependent on the program for its business.

The SBA's failure to consider its own Standard Operating Procedures raises a serious question whether the Wedtech extension was granted out of a desire to assist a favored company. In interviews with the Subcommittee staff, several current and former SBA officials who dealt with Wedtech stated that the company was viewed as a special case and accorded favorable treatment in the New York District and Regional SBA offices. For example, former SBA New York District Director Harry Tishelman told the Subcommittee staff that "[t]hey were obviously politically well-connected"; former New York District Counsel David Elbaum testified that "they were politically well-connected";[79] and SBA Business Development Specialist Andy Murtagh stated that "[t]hey had strong political connections." Mr. Murtagh told the Subcommittee staff, "Anything the wanted, they got. . . . Everyone was scared; everyone knew there was pressure", while SBA contracts officer Richard Zilg stated that "people were afraid" that the company would be found ineligible.

There is some evidence that the SBA's 8(a) extension decision in particular may have been the result of a concerted campaign by Wedtech to pressure the SBA. At the time the extension decision was made, Wedtech was seeking the $200 million Navy pontoon contract. There is substantial evidence that the two decisions were linked by both Wedtech and the SBA:

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[79] Hearing Record, Part 1 at 108.

(1) A series of memoranda written by Wedtech consultant E. Robert Wallach indicate that the company sought to remain in the program for the express purpose of pursuing the pontoon contract.

(2) Wedtech's former Executive Vice President told the Subcommittee staff that he met with the former New York Regional Administrator, Peter Neglia, on a regular basis to discuss Wedtech's eligibility and its efforts to get the pontoon contract.

(3) Mr. Neglia played a direct and substantial role in advocating continued eligibility for Wedtech and in pushing Wedtech as a candidate for the pontoon contract.

(4) The SBA's District Counsel, David Elbaum, testified that he was told by Mr. Neglia to reach a quick decision on the eligibility issues "because there was a conference of some kind in Washington with regard to a contract that was to be awarded to Wedtech".

(5) The extension was granted by the SBA's Washington office on the same day that Wedtech was introduced to the Navy as the SBA's candidate for the pontoon contract.

(6) The SBA's former Deputy Associate Administrator, Robert Saldivar, signed the extension letter and played a direct role in the selection of Wedtech as the SBA's candidate for the pontoon contract.

For these reasons, the Subcommittee finds that the SBA improperly granted Wedtech a three-year extension of its 8(a) term without considering the factors set forth in its Standard Operating Procedures. The circumstances of this decision create at a minimum the appearance that it was made for the purpose of awarding a lucrative contract to a well-connected and favored company.

C. The Navy's Set-Aside of the Pontoon Contract

1. THE NAVY'S REVERSAL

a. The Initial Decision.—Pontoon causeways are a vital component of the Rapid Deployment Force—a force designed to be highly mobile and capable of responding to crisis situations around the world. In order to be effective, the Rapid Deployment Force needs large quantities of supplies, including everything from food and ammunition to tanks and jeeps. For this reason, three squadrons of maritime "pre-positioned ships" have been purchased by the Navy, loaded with these supplies, and placed in key areas around the world.

Under ordinary circumstances, these huge ships would require deep water ports to unload their supplies. The Rapid Deployment Force, however, might be needed in areas distant from deep water ports. The Navy planned to resolve this problem by equipping each pre-positioned ship with small craft designed to carry the supplies from ship to shore where there is not an improved port available. Pontoon causeways are small craft designed specifically for this purpose.

A pontoon causeway consists of a chain of motorized and non-motorized pontoon assemblies. Motorized assemblies function as tug boats, while non-motorized assemblies function as barges. Each pontoon assembly (motorized or non-motorized) is a rigid framework into which buoyant steel boxes (pontoons) are fit, "very much like ice cubes in an ice cube tray." [1] The pontoons are designed to be removable and replaceable so that they can be repaired, if necessary, in wartime conditions.

The first pre-positioned ships—destined for the most critical hot spots around the world—were scheduled to be completed, and to leave port, in October 1984. Thus, when the Navy decided to contract for pontoon causeways in the fall of 1983, it had little lead time for the production of the causeways. As Acting Assistant Secretary Everett Pyatt explained to the SBA in early 1984, "the operational needs of the Navy for these systems are critical": [2]

> As has been discussed, the successful and timely execution on the production quantities of powered causeways is critical to the scheduled deployment of the Maritime Prepositioning Ships (MPS) set for next fall.[3]

For this reason, among others, there was strong sentiment in the Navy that an existing shipbuilding company with substantial experience should be chosen to build the pontoon causeways.

In the summer of 1983, several 8(a) companies became aware that a Navy contract for the construction of pontoon causeways

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[1] Hearing Record, Part 2 at 18 (Testimony of Capt. de Vicq).
[2] February 9, 1984 letter from Mr. Pyatt to Mr. Sanders.
[3] January 6, 1984 letter from Mr. Pyatt to Mr. Sanders.

was likely to be awarded in the near future. These companies geared up to secure the contract through the 8(a) program and contacted the SBA, which encouraged them to pursue the requirement.

The Navy initially resisted all efforts to set the pontoon contract aside for any 8(a) company. Navy officials have told the Subcommittee that this opposition was based on (1) the short lead-time available for the production of the pontoons; (2) the massive size of the contract, which might eventually amount to as much as $500 million; (3) the complexity of the contract and associated documentation and quality requirements; (4) the fact that a small business named Jeffboat—which had contracted to build pontoons several years earlier—had failed to produce acceptable pontoons on schedule; (5) the fact that many existing shipbuilding facilities around the country were idle for lack of work; (6) a general preference for competitive procurements.[4]

In testimony before the Subcommittee, Assistant Navy Secretary Everett Pyatt explained why he initially opposed the set-aside of the contract:

> I believed that the size of the program and, from what I could tell around that there were no 8(a) firms in the metal fabrication that were minority firms that could handle a program of this scope, while I knew there were firms in the small business, particularly along the Great Lakes and in the Southeast, that were fully capable of handling this kind of work.[5]

Admiral Thomas J. Hughes, the former Deputy Chief of Naval Operations for Logistics, explained his objections as follows:

> First of all, we were late, and that has to hang over everything. We had to worry about meeting the time schedule, and we were hopeful of meeting from the beginning the [schedule for the launching of the first pre-positioned ship].
>
> In going with an organization that had not done this work before, and that did not have any record that we could see of success in this line of business, we felt it was too chancy. It was a big contract, and we thought that we ought to go competitively with a major company and try to speed up the action to make the time frame, and we felt we had a much better quality control, and that we had a much better chance and reliability for delivery.[6]

Under these circumstances, many Navy officials believed that the pontoons were too important, and the motorized ones too complex, to be trusted to an inexperienced business.

On August 15, 1983, Mr. Pyatt responded to an inquiry from Senator Laxalt of Nevada with a letter in which he stated that the Navy would not set aside the pontoon contract. Mr. Pyatt explained the "technically demanding" nature of the contract and concluded:

> The procurement program is expected to total several hundred million dollars over the next five years. For a program of this size, which could be carried out at a number of existing fabrication/shipbuilding facilities, the potential for competition and resulting economies to the government are extremely appealing. Therefore, we plan to procure the equipment competitively, rather than by 8(a) set-aside.

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[4] Hearing Record, Part 2 at 136 (Testimony of Mr. Pyatt); *Id.* at 80 (Testimony of Admiral Hughes); *id.* at 10–11 (Testimony of Capt. de Vicq); August 15, 1983 letter from Mr. Pyatt to Senator Laxalt; January 3, 1984 memorandum from Cdr. Troy re: SECNAV Involvement in Causeway Procurement; January 4, 1984 memorandum from Cdr. Troy re: FY 84 Powered Causeway Procurement.

[5] Hearing Record, Part 2 at 136.

[6] Hearing Record, Part 2 at 80.

Similar letters rejecting efforts to have the contract set aside were sent over the course of the next month to Senator Chic Hecht, to then-Representative Harry Reid, and to the SBA.

b. The SBA Appeal.—In early October 1983, after the public stock offering and Wedtech's admission that it was no longer owned by disadvantaged individuals, Wedtech heard about the pontoon contract and decided actively to pursue it through the 8(a) program. Mario Moreno, a former Executive Vice President and Director of Wedtech, has told the Subcommittee staff that Wedtech employed consultants including Mark Bragg, E. Robert Wallach, General Bernard Ehrlich, General Vito Castellano, and Stephen Denlinger in its efforts to influence the Navy's decision. According to Mr. Moreno, these consultants promoted Wedtech's efforts by contacting government officials including then-Counselor to the President Edwin Meese III, Navy Secretary John Lehman, Assistant Secretary Everett Pyatt, Navy Small Business Director Richard Ramirez, SBA Administrator James Sanders, Deputy Associate Administrator Robert Saldivar, Regional Administrator Peter Neglia, Congressman Joseph Addabbo, Congressman Mario Biaggi, and Senator Alphonse D'Amato.[7]

On November 8, 1983, SBA Administrator James Sanders wrote to Secretary Lehman to appeal the Navy's decision not to set aside the pontoon contract for performance by an 8(a) company. Mr. Sanders subsequently met with Mr. Pyatt to discuss the possibility of a set-aside. Mr. Sanders and Mr. Pyatt agree that Mr. Sanders pushed for a set-aside of the contract on the ground that it would be a good idea to establish a disadvantaged company in the "metal fabrication" business. Mr. Sanders testified that he does not remember personally appealing any other 8(a) contract decision to an agency head or Assistant Secretary such as Mr. Pyatt.[8] Mr. Pyatt testified that he met with Mr. Sanders two or three times about small business issues in the last half of 1983,[9] that he discussed such issues with Mr. Sanders on the telephone as often as two or three times a month,[10] and that on at least some of these occasions, Mr. Sanders lobbied him to set aside particular contracts.[11]

In fact, Mr. Pyatt's office calendar reflects only one phone call and one meeting between Mr. Pyatt and Mr. Sanders between January 1983 and December 1984—a September 17 phone call and a December 15, 1983, meeting about the pontoon contract. Mr. Pyatt's telephone logs, which go back only to August 1984, do not reflect any telephone calls to or from Mr. Sanders for the balance of that year. In response to a post-hearing question from the Subcommittee, Mr. Pyatt stated that the pontoon contract was the only contract that Mr. Sanders had ever specifically asked him to set aside, although he did recall "a discussion that we had about an electronics firm, the name of which I still cannot remember." [12]

In a December 8, 1983, letter to Mr. Sanders, Mr. Pyatt reversed his initial decision not to set aside any of the pontoon contract and

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[7] Affidavit of Mr. Moreno, Paragraph 4.
[8] Hearing Record, Part 1 at 149.
[9] Hearing Record, Part 2 at 137.
[10] Hearing Record, Part 2 at 140–41, 150–51.
[11] Hearing Record, Part 2 at 150–51.
[12] November 16, 1987 letter from Mr. Pyatt to the Subcommittee.

agreed to set aside a small portion of the contract—the non-motorized pontoon units—for performance by an 8(a) company. The non-motorized units were the least complex and least risky part of the contract that could be assigned to a small disadvantaged business. As Mr. Pyatt explained in testimony before the Subcommittee, the non-motorized units were "the piece of the design that was best under control, that someone could pick up, and was the easiest to do of the motorized and non-motorized versions." [13] This portion of the contract was valued at approximately $5 million of a total $25 million in the first year of the contract.

Admiral Hughes and Captain David de Vicq, the uniformed Navy personnel primarily responsible for the performance of the contract, testified that they still preferred that none of the contract be set aside. However, they reluctantly agreed to a partial set-aside of the non-powered units as the least urgent and least risky part of the contract.[14] In testimony before the Subcommittee, Mr. Pyatt stated that Mr. Sanders had persuaded him to change his mind on the issue:

> Senator LEVIN. And on December 8th, you appeared to have changed your mind. You sent a letter to Sanders in which you agreed to set aside the non-motorized portion of the contract—that was December 8th, 1983—is that correct?
>
> Mr. PYATT. That is correct. That is the piece of it that the design was best under control and could be picked up.
>
> Senator LEVIN. Could you tell us why you changed your mind on this issue between November 8th, 1983, when Sanders appealed your decision not to set it aside, and December 8th, when you changed your mind and agreed to set aside a portion of the contract—what changed your mind in that month?
>
> Mr. PYATT. . . . Mr. Sanders made the case that he would like to establish the 8(a) program in developing metal fabrication in 8(a) firms. I know enough about this business that that is a legitimate policy goal, and it is a perfectly achievable thing to do, and I knew of no basis to—I explained my reservations about the state of the program; he said he understood those and wanted to proceed, and would I come along. And without a logical objection . . . I agreed.[15]

However, Mr. Pyatt acknowledged that he had not met with Mr. Sanders between November 8, 1983, the date of Mr. Sanders' appeal letter to then-Secretary Lehman, and December 8, 1983. Mr. Pyatt stated that the meeting at which he and Mr. Sanders discussed the pontoon contract took place in mid-December—after his December 8 letter.[16] This statement is confirmed by Mr. Pyatt's office calendar, which reflects only one meeting with Mr. Sanders—on December 15, 1983.

c. The Set-Aside Decision.—In an affidavit prepared for the Subcommittee, Mario Moreno stated that Wedtech learned of Mr. Pyatt's decision to set aside the non-motorized part of the pontoon contract through Richard Ramirez—an assistant to Mr. Pyatt—before the December 8, 1983, letter was sent.[17] Mr. Moreno stated that the set-side of part of the contract was not acceptable to Wedtech—that "Wedtech would not accept just the non-motorized portion of the contract." [18] In an interview with the Subcommittee

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[13] Hearing Record, Part 2 at 137.
[14] Hearing Record, Part 2 at 8, 11-12, 81.
[15] Hearing Record, Part 2 at 137.
[16] Hearing Record, Part 2 at 137, 150.
[17] Affidavit of Mr. Moreno, Paragraph 8(b).
[18] Affidavit of Mr. Moreno, Paragraph 6(b).

staff, Mr. Moreno explained that Wedtech continued actively to push for the set-aside of the entire contract after it learned of the December 8, 1983, letter.

As late as January 3, 1984, Navy officials believed that Mr. Pyatt continued to oppose the award of the motorized pontoons to the SBA.[19] On January 4, however, Mr. Pyatt called a meeting at which he appeared to shift positions, leaning toward a full set-aside. On January 6, Mr. Pyatt sent a letter to Mr. Sanders in which he formally agreed to "entertain" the set-aside of the entire pontoon contract:

> SBA's interest in establishing a Section 8(a) program reservation for the FY 84 requirements for these items [the pontoons] has been further reviewed. I am pleased to advise that the Department is willing to entertain the placement of the entire current year program for contracting with your agency.

Mr. Pyatt testified that he was aware at the time he wrote this letter that Wedtech was the most likely contractor.[20] However, the Navy does not appear to have made any attempt to determine whether Wedtech was qualified to perform the contract until late January or early February.[21]

In his testimony before the Subcommittee, Mr. Pyatt emphasized that he agreed only to "entertain" the set-aside of the pontoon contract in his January 6 letter to Mr. Sanders, and that this decision was not final:

> Mr. PYATT. . . . We agreed to entertain—I did not say we agreed to do it—but we agreed to entertain—send us over somebody to look at. So it was in this light rather than we have decided to do it.[22]

Mr. Pyatt testified that his decision did not become final until the contract was negotiated and signed in April 1984.[23] As a practical matter, however, Mr. Pyatt's letter put an immediate stop to the competitive bidding process. As a January 19, 1984 Navy memorandum explained:

> On 4 January 1984, [Mr. Pyatt's office] orally advised [NAVFAC] that the procurement would have to be set aside for disadvantaged small business under the "8a" program contracted by the Small Business Administration (SBA). The CBD announcement process [for competitive bidding] was therefore stopped. Preparations for an 8(a) negotiated procurement were immediately undertaken. The procurement package will be ready to deliver to SBA no later than Monday, 23 January 1984.[24]

Mr. Pyatt's letter committed the Navy to consider the SBA's candidate first, and to withdraw the contract from the 8(a) program only if agreement could not be reached.[25] In effect, Mr. Pyatt's letter shifted the burden to the Navy to prove that the SBA's candidate could *not* perform the contract. As Mr. Pyatt himself explained:

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[19] January 3, 1984 memorandum from Cdr. Troy to Admiral Hughes.

[20] Hearing Record, Part 2 at 139.

[21] Hearing Record, Part 2 at 81-82, 89 (Testimony of Admiral Hughes). In an interview with the Subcommittee staff, Mr. Pyatt confirmed that the SBA sent him the names of several potential 8(a) contractors prior to his letter setting aside the entire contract. Mr. Pyatt explained: "Out of that [mid-December] discussion [with Mr. Sanders], he said he would send up some names. These firms came over, and it quickly evolved that Wedtech was the leader."

[22] Hearing Record, Part 2 at 152.

[23] Hearing Record, Part 2 at 152-53.

[24] January 19, 1984 memorandum re: FY 1984 Procurement for Sealift Support Facilities Program (SSFP).

[25] *See* January 6, 1984, letter from Mr. Pyatt to Mr. Sanders referring to the Navy's "offering" of the "opportunity" to the SBA).

Mr. PYATT. . . . [W]e could have reversed it if something had come up that had said we really [had] to do it. But I also say that we would have had a lot of Congressman down our backs for doing it, but that is all right.[26]

Contemporaneous Navy memoranda in January 1984 treat Mr. Pyatt's January 6, 1984 letter as a final decision to offer the pontoon program to the SBA for performance by an 8(a) contractor, subject to later reversal if agreement could not be reached.[27]

Mr. Pyatt's decision to set aside the entire contract was strongly opposed by the uniformed Navy.[28] Admiral Hughes testified before the Subcommittee that he spoke to Mr. Pyatt on January 4, 1984—two days before the set-aside decision was made—and argued against even a partial set-aside of the non-motorized units, let alone the more complex motorized units.[29] As explained in a January 3, 1984 Navy memorandum, Admiral Hughes and other Navy officials told Mr. Pyatt that the pontoons were too complex for an 8(a) company to handle:

We have told ASN [Mr. Pyatt] that the powered units are too complicated for a railroad car or grain elevator company to build and cited as an example the program currently being experienced by JEFFBOAT, the largest inland boat builder in the U.S., who has been trying since 27 SEP to pass first article tests. Our premise has been that if a company that normally builds boats is having trouble, that trouble would be compounded by giving the work to someone who has had no nautical experience.[30]

Admiral Hughes added that he was surprised and disappointed when he learned of Mr. Pyatt's January 6, 1984, decision to go ahead with a total set-aside despite his contrary recommendation.[31]

Mr. Pyatt testified that he decided to set-aside the entire pontoon contract because (a) Mr. Sanders had convinced him that this was a good opportunity to bring an 8(a) company into the metalworking business; [32] and (b) there was substantial pressure on the Navy to meet its annual 8(a) "quotas".[33] Mr. Pyatt acknowledged, however, that the rationale for his set-aside decision was never put on paper. He explained that numerous Navy decisions are never documented on paper, but acknowledged that such documentation is particularly important in cases where there is no competition.[34] Mr. Pyatt

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[26] Hearing Record, Part 2 at 153.

[27] *See* January 5, 1984 memorandum from Cdr. Troy re: FY84 Powered Causeway Project ("At a meeting 04JAN at ASN(S&L), it was indicated that a decision has been made to offer the FY84 Powered Causeway (PCS) procurement to the Small Business Administration as an 8A (minority) award"); January 19, 1984 memorandum re: FY 1984 Procurement for Sealift Support Facilities Program (SSFP) ("On January 4, 1984, [Mr. Pyatt] orally advised [NAVFAC] that the procurement would have to be set aside for disadvantaged small business under the '8(a)' program contracted by the Small Business Administration (SBA).")

[28] Hearing Record, Part 2 at 10–11 (Testimony of Capt. de Vicq).

[29] Hearing Record, Part 2 at 86–87, 81–82. In a subsequent interview with the Subcommittee staff, Admiral Hughes stated that Commander Troy attended the January 4 meeting on his behalf. Admiral Hughes explained that the conversation he remembered with Mr. Pyatt was a telephone conversation at or about the same time.

[30] January 3, 1984 memorandum of Cdr. Troy re: SECNAV Involvement in Causeway Project.

[31] Hearing Record, Part 2 at 81, 88.

[32] Hearing Record, Part 2 at 134, 137–38, 150.

[33] Hearing Record, Part 2 at 149, 163. In response to post-hearing questions from the Subcommittee, Mr. Pyatt acknowledged that the Navy has a total goal for awards to small and disadvantaged businesses (SDB's), but no separate target for 8(a) awards. Statistics provided by Mr. Pyatt's office indicate that the Navy exceeded its FY 1984 SDB goal by $80 million—meaning that this goal would have been met and exceeded even without the award of the pontoon contract.

[34] Hearing Record, Part 2 at 151–52.

stated that he was not deterred his from set-aside decision by the opposition of the uniformed Navy, because he had "never seen a military man supporting an 8(a) program." [35]

Navy officials at NAVFAC—the Navy command responsible for performance of the pontoon contract—were not immediately informed of Mr. Pyatt's January 6, decision to set aside the pontoon contract. On January 19, 1984, Mr. Pyatt convened a meeting to allow key Navy personnel responsible for the contract to air issues about the set-aside of the pontoon contract. As Captain de Vicq testified, some of the Navy personnel present were still not aware that a decision had already been made.[36]

Uniformed Navy officials present at the January 19, 1984, meeting have stated that the burden was placed on them to prove that an 8(a) company could *not* perform the contract. Captain de Vicq presented a detailed point paper which showed—as Admiral John Paul Jones described it in an interview with the Subcommittee staff—that there was "no way an 8(a) firm could tool up and meet the delivery schedules." [37] Captain de Vicq's objections were seconded by the other senior Navy officers present, but "as strongly as we presented the case, it did not seem to have any effect." [38] Shortly after the meeting, NAVFAC personnel learned that the contract would be set aside despite their objections.[39]

In his testimony before the Subcommittee, Mr. Pyatt stated that the purpose of the January 19 meeting was to provide NAVFAC personnel an opportunity to "lay all of the issues on the table." [40] Mr. Pyatt explained that he did not view the issue as having been finally decided by his January 6 letter because the Navy had agreed only to "entertain" the set-aside and had not yet had an opportunity to review the SBA's candidates for the contract.[41] As explained above, however, Mr. Pyatt's January 6 letter did shift the burden to Navy officials to prove that an 8(a) contractor could not do the work.[42]

2. WEDTECH'S EFFORTS TO INFLUENCE THE NAVY

Mr. Pyatt testified that no political pressure was brought to bear on him to set aside the pontoon contract:

> Senator COHEN. So in other words, no pressure was brought from anyone in the White House or outside of the White House or connected to the White House to cause you to decide that this should go Section 8(a) with the complete contract going to Wedtech?
>
> Mr. PYATT. That is correct. The only pressure that I perceived was the pressure that we have to make 8(a) goals in terms of dollar volume produced every year; we get graded on that; we get put on report if we do not make it. That pressure exists. It existed then, but it was not related to this particular company.[43]

In a January 5, 1984 memorandum to Admiral Hughes, Commander Thomas G. Troy took a different view. This memorandum,

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[35] Hearing Record, Part 2 at 144.
[36] Hearing Record, Part 2 at 13–14.
[37] *See* Point Paper for January 19, 1984 meeting.
[38] Hearing Record, Part 2 at 13 (Testimony of Capt. de Vicq).
[39] Hearing Record, Part 2 at 13–14 (Testimony of Capt. de Vicq).
[40] Hearing Record, Part 2 at 139, 145.
[41] Hearing Record, Part 2 at 139, 145–46.
[42] *See* Hearing Record, Part 2 at 139, 153.
[43] Hearing Record, Part 2 at 149.

which summarizes the status of the pontoon contract in light of a January 4 meeting with Mr. Pyatt, states that the set-aside decision was reportedly influenced by political pressure:

> At a meeting 04JAN at ASN(S&L) [Mr. Pyatt's office], it was indicated that a decision has been made to offer the FY 84 Powered Causeway (PCS) procurement to the Small Business Administration as an 8A (minority) award. Decision was reportedly influenced by political pressure brought to bear on ASN [Mr. Pyatt].[44]

Despite a Subcommittee request to the Navy for all documents relevant to the pontoon contract, and the Navy's purportedly complete response to that request, this memorandum was not supplied to the Subcommittee and its existence was not disclosed until after Admiral Hughes discussed it in his testimony.[45]

a. Wedtech's Allegations.—In a sworn affidavit provided to the Subcommittee, former Wedtech Executive Vice President Mario Moreno stated that:

(1) He had regular conversations with Mark Bragg—a partner of former White House political advisor Lyn Nofziger—about the pontoon contract in the fall of 1983. Mr. Bragg reported to Mr. Moreno that he had spoken directly to Mr. Pyatt on several occasions and to Navy Secretary John Lehman on at least one occasion in an effort to get the pontoon contract for Wedtech.[46]

(2) He had regular conversations with Wedtech consultant E. Robert Wallach about the pontoon contract in the fall of 1983. Mr. Wallach reported that he had spoken to "his friend" about Wedtech and the pontoon contract and that, at one point, "his friend" had called the Secretary of Defense, Caspar Weinberger, in an effort to get the pontoon contract for Wedtech. In the context of previous conversations with Mr. Wallach, Mr. Moreno assumed that "his friend" was Edwin Meese III, then the counselor to the President.[47]

(3) He had regular conversations with New York National Guard Generals Ehrlich and Castellano about the pontoon contract in the fall of 1983. Generals Ehrlich and Castellano reported that they

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[44] Commander Troy, who wrote the memorandum, explained to the Subcommittee staff that Richard Ramirez, Mr. Pyatt's Small Business aide, told him of the pressure on the Assistant Secretary's office. Commander Troy reported that Mr. Ramirez told him that the pressure was coming from someone "heavy", but would not tell him any more. Mr. Ramirez, who is the target of several ongoing investigations arising out of his own role in the pontoon contract, invoked his 5th Amendment privilege and declined to be interviewed by the Subcommittee staff. Mr. Ramirez' attorney, Les Lepow, told the Navy in a March 13, 1987, interview that Mr. Ramirez understood (a) that the pontoon contract was the subject of much pressure; (b) that Mr. Nofziger was part of this pressure; and (c) that the Assistant Secretary was contacted by Messrs. Nofziger and Bragg on behalf of Wedtech prior to the award of the contract. Mr. Lepow stated that Mr. Ramirez had never actually met Mr. Nofziger.

[45] *See* October 27, 1987 letter from Mr. Pyatt to the Subcommittee. The Subcommittee learned in November 1987 that a chronology of key Navy documents was prepared for Admiral Hughes for use in this testimony; the documents listed in this chronology were provided to the Subcommittee only after a specific request. At about the same time, the Subcommittee learned that the Assistant Secretary's office had prepared a report on Mr. Ramirez' role in the pontoon contract. Despite the Subcommittee's standing request for all documents related to Wedtech, this document, too, was provided only after a specific supplemental request.

While the Subcommittee requested "all documents in the Navy's possession" regarding the pontoon contract, the Navy response represented only that "the documentation held by the Naval Facilities Engineering Command" had been provided. Documents later obtained by the Subcommittee from Mr. Pyatt's office indicate that this was a conscious choice: one internal memorandum from that office specifically states: "We are not providing all 'Navy information' relative to the contract[,] just that held by NAVFAC." *See* Discussion Paper, Subj.: Senator Levin Request for Information on Wedtech Corp.

[46] Affidavit of Mr. Moreno, Paragraph 5.

[47] Affidavit of Mr. Moreno, Paragraph 6.

had spoken to Congressmen Biaggi and Addabbo and learned that Congressman Addabbo and Senator D'Amato had called Navy Secretary John Lehman in an effort to get the pontoon contract for Wedtech.[48]

(4) He had regular conversations with Richard Ramirez about the pontoon contract in the fall of 1983. Mr. Ramirez reported that, after early opposition to the set-aside of the pontoon contract, Mr. Pyatt changed his mind and became an advocate of the set-aside.[49]

Mr. Moreno's statements are supported in part by Mr. Wallach. Two file memoranda written by Mr. Wallach in late 1983 indicate Mr. Wallach's apparent knowledge—before an official decision had been made—that Mr. Pyatt would agree to set aside the pontoon contract. On November 9, 1983, one day after Mr. Sanders appealed to Secretary Lehman the Navy's initial decision not to set aside the contract, Mr. Wallach wrote, "The Asst. Secretary of the Navy by the name of Piot [sic] [h]as indicated [th]at Wedtech, is a prime recipient [of the pontoon contract]." On December 7, 1983, one day before Mr. Pyatt's letter to Mr. Sanders setting aside a portion of the pontoon contract, Mr. Wallach wrote:

> I am advised of the following information: Secretary Piot's [sic] office from the Navy with Richard Ramirez writing the letter will issue a letter which will set out qualifications that really apply only to Wedtech. Delivery will be to the east coast first and will include elements of the propulsion as well as the non-propulsion portions of the contract. In other words, it should be terrific.

Although Mr. Pyatt acknowledged in his testimony before the Subcommittee that Mr. Wallach's prediction that he would set aside the entire pontoon contract "turned out to be true",[50] he denied that he reached this decision until he met with Mr. Sanders in mid-December—well after Mr. Wallach wrote his memoranda.[51]

In an interview with the Subcommittee Chairman and staff, Mr. Wallach stated that the information in his November 9 and December 7 memoranda came from Mr. Bragg, whom he understood to be in regular contact with Mr. Pyatt.

> Mr. WALLACH. I have to plumb my memory for it, but it's my recollection that he [Mr. Bragg] was regularly engaged in talking with the Navy on behalf of Wedtech, including periodically Assistant Secretary Pyatt.
>
> SUBCOMMITTEE STAFF. And do you have any idea what period that would cover?
>
> Mr. WALLACH. It was certainly before the contract was awarded and certainly during the problems with the options, but I don't know what months.[52]

b. The Assistant Secretary's Denial.—Mr. Pyatt denied in testimony before the Subcommittee that he spoke to Mr. Nofziger or Mr. Bragg prior to the award of the pontoon contract in April 1984, or that they even sought a meeting with him about Wedtech:

> Senator LEVIN. Now, prior to January of 1984, did you discuss the pontoon contract with either Lyn Nofziger or Mark Bragg?
>
> Mr. PYATT. No.
>
> Senator LEVIN. And did either Mr. Nofziger or Mr. Bragg contact you to seek a meeting on that subject prior to that time?
>
> Mr. PYATT. No, I do not think so—no.[53]

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[48] Affidavit of Mr. Moreno, Paragraph 7.
[49] Affidavit of Mr. Moreno, Paragraph 8.
[50] Hearing Record, Part 2 at 159.
[51] Hearing Record, Part 2 at 137-138.
[52] Transcript of June 29, 1987 interview of Mr. Wallach at 117.
[53] Hearing Record, Part 2 at 155.

In fact, Mr. Pyatt stated he did not believe he had even met Mr. Nofziger at this time:

> Senator LEVIN. Can you tell us when your first conversation was with Mr. Nofziger?
>
> Mr. PYATT. I do not know. I think it was sometime subsequent to the award of the contract, but I am not sure when.[54]

Former Navy Secretary John Lehman has told the Subcommittee that *he* met with Lyn Nofziger and others about Wedtech's efforts to get the pontoon contract on at least one occasion; his recollection is that Mr. Nofziger brought several Wedtech officials into his office to discuss the contract. This is confirmed by Mr. Nofziger's office calendar, which reflects a December 16, 1983 meeting with Mr. Lehman. Mr. Lehman stated that he took no action on behalf of Wedtech as a result of this meeting. Although he has no specific recollection, he assumed that he had referred Mr. Nofziger and Wedtech to the Navy office in charge of the procurement, which, he stated, was Mr. Pyatt's office.

Other evidence received by the Subcommittee appears to support the statements of Mr. Moreno and Mr. Wallach that Mr. Pyatt—despite his testimony to the contrary—also met with Mr. Nofziger and/or Mr. Bragg prior to the award of the contract.

First, a calendar maintained by Mr. Pyatt's secretary and provided to the Subcommittee after the hearing indicates that Mr. Pyatt met with Mr. Nofziger at least three times in September and October 1983. In addition, the calendar shows that Mr. Pyatt accepted an invitation to an anniversary celebration of the Nofziger and Bragg firm February 2, 1984. The Subcommittee is unable to determine how frequently—if at all—Mr. Pyatt may have spoken to Mr. Nofziger or Mr. Bragg on the telephone prior to the award of the contract, because Mr. Pyatt's office did not begin to log telephone calls until August 1984.

Second, a February 16, 1984, memorandum provided to the Subcommittee by the Naval Facilities Engineering Command (NAVFAC) notes a telephone call from "Mr. Nosinger (Spelling?), President's Political Advisor, relative to the delivery date of the technical proposal from Wedtech." The memorandum reports that the call came in to Mr. Pyatt's office. Mr. Pyatt stated in his testimony before the Subcommittee that somebody in his office responded to the call from Mr. Nofziger, but he did not.[55]

Third, Mr. Pyatt's files contained a memorandum on unmarked paper, with the handwritten date "Nov. 1" that laid out Wedtech's plan for performing the pontoon contract, with subcontracts to other 8(a) firms in areas such as Puerto Rico, Texas, and Pennsylvania. A second copy of the same document, obtained from Wedtech's files, has a handwritten note in the upper right-hand corner, which states:

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[54] Hearing Record, Part 2 at 155. In an interview with the Subcommittee staff, Mr. Pyatt was uncertain as to when he first met Mr. Bragg. First, Mr. Pyatt stated that he "did know Mark [Bragg]" prior to the award of the pontoon contract, but was "pretty sure" that he didn't speak to him. Later in the same interview, Mr. Pyatt stated that he "didn't know Mark Bragg before this at all." Finally, Mr. Pyatt concluded that he "may have met" Mr. Bragg prior to the award of the contract.

[55] Hearing Record, Part 2 at 155.

Mario, this is the piece that Lyn and Mark will be using with SBA and Navy. Steve.

In his testimony before the Subcommittee, Mr. Pyatt stated that he had never seen this memorandum before.[56]

In addition, Mr. Pyatt's testimony about his relationship with Messrs. Nofziger and Bragg subsequent to the award of the contract raises questions about his assertion that he was not already acquainted with the two Wedtech lobbyists. Mr. Pyatt testified that shortly after the award of the contract to Wedtech, he initiated a telephone call to Mr. Bragg to ask him his assistance in dealing with Wedtech. Mr. Pyatt stated that he had no idea how he knew that Messrs. Nofziger and Bragg were representing Wedtech at this time:

Mr. PYATT. . . . I do not know how I learned it, but I did know it; otherwise I could not have made the call. But I just do not know. But it was in the stage when the contract was trying to get started . . .[57]

Mr. Pyatt's office logs reflect five meetings and seven telephone calls between Mr. Pyatt and Mr. Bragg in the last seven months of 1984, as well as a December 4, 1984, telephone call from Mr. Pyatt to Mr. Nofziger.

Mr. Pyatt's statements to the Subcommittee about his relationship with Messrs. Nofziger and Bragg subsequent to the award of the contract contain numerous inconsistencies. First, in a September 21, 1987, interview with the Subcommittee staff, Mr. Pyatt acknowledged that his nomination to become Assistant Secretary was held up at the White House for almost a year in 1983–84. He stated his belief that this was because "the political folks didn't know what to do with a civil servant. That was an issue." After his nomination was finally sent to the Senate, Mr. Pyatt recalled, Mr. Nofziger congratulated him. As Mr. Pyatt described this convention, "One time, I was talking to Nofziger, after the nomination came down. He said that 'one of the big mistakes we made was not recognizing that people in the civil service can help us.' " Asked when this conversation took place, Mr. Pyatt responded, "I think it was close to when it was a done deal," "when I was up for confirmation."[58] Mr. Pyatt's nomination was considered by the Senate Armed Services Committee on July 31, 1984.[59]

In his testimony before the Subcommittee nine days after his interview with the staff, Mr. Pyatt expressed a different recollection of this episode. Asked first whether he had ever discussed his nomination with Mr. Nofziger, Mr. Pyatt responded: "I do not think so. I will answer 'No.' " Asked whether Mr. Nofziger had congratulated him on his nomination, Mr. Pyatt replied: "I do not know. Several people did, and some gave me condolences." Asked about the episode he had related to the Subcommittee staff the week before, Mr. Pyatt acknowledged that the conversation had

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[56] Hearing Record, Part 2 at 160.
[57] Hearing Record, Part 2 at 155–56.
[58] Mr. Pyatt also stated that this conversation took place "after it was done" and "after the nomination came down." Mr. Pyatt became acting Assistant Secretary when George Sawyer left the Navy in April 1983; his nomination as Assistant Secretary was announced by the White House on April 17, 1984—the same day the pontoon contract was awarded to Wedtech.
[59] S. Hearing 98–1059.

taken place.[60] However, Mr. Pyatt denied that this convention took place while he was up for confirmation:

Mr. PYATT. . . . What I recalled saying in that meeting was later; I do not recall anything about the timing. It was certainly afterwards, after I had been confirmed.
Senator LEVIN. That conversation was after you were confirmed?
Mr. PYATT. Yes, sir.[61]

Second, Mr. Pyatt acknowledged, in response to a specific question in an interview with the Subcommittee staff, that he had several lunches at the offices of Messrs. Nofziger and Bragg.[62] In his interview with the Subcommittee staff, Mr. Pyatt stated that he agreed to these lunches on the condition that there be no discussion of business—"I grew to like Nofziger. A couple of times, he invited me to lunch. I insisted that there be no discussion of business." This was confirmed to the Subcommittee by Wedtech consultant and former White House staffer Jim Jenkins, who attended one of the lunches. Mr. Jenkins informed the Subcommittee that he remembers attending a "fall lunch"—presumably in 1985—with Messrs. Pyatt, Nofziger and Bragg, at which Mr. Pyatt "specifically and unequivocally announced at beginning that he would not talk about Wedtech."

In his testimony before the Subcommittee, however, Mr. Pyatt asserted that he not only refused to discuss business with Messrs. Nofziger and Bragg, but met with them only because he understood that they longer represented any defense contractors at all:

Mr. PYATT. . . . I only agreed to have lunch when it was clear they were not in the defense business anymore.
Senator LEVIN. But weren't they representing Wedtech?
Mr. PYATT. They told me they were not; at the time that we met, they were not representing anyone in the defense business. So this would be sometime much later.

* * * * * * *

Senator LEVIN. . . . Just so we can have a real clear answer, then, you specifically asked Bragg and Nofziger whether or not they any longer represented anybody in the defense business prior to your having lunch with them, and they answered "No"?
Mr. PYATT. Mr. Bragg did.
Senator LEVIN. Mr. Bragg answered "No"?
Mr. PRATT. Yes.
Senator LEVIN. And Mr. Nofziger?
Mr. PYATT. I did not ask him that.[63]

Wedtech check registers indicate that Messrs. Nofziger and Bragg continued to be paid by the company until at least April 1986. In response to post-hearing questions, Mr. Pyatt stated that Mr. Bragg's statement was made in connection with a May 15, 1986, lunch with Messrs. Nofziger and Bragg and was not reduced to writing. However, the calendars of Messrs. Nofziger and Bragg

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[60] Hearing Record, Part 2 at 156–57.
[61] Hearing Record, Part 2 at 157.
[62] As Mr. Pyatt explained, "I got acquainted with him [Nofziger] after the discussion in the context of my confirmation. Then we just started talking. He later invited me for lunch." Mr. Pyatt's office calendars reflect a May 15, 1986 lunch with Messrs. Nofziger and Bragg. Mr. Nofziger's calendars reflect two additional lunches with Mr. Pyatt, one on July 19, 1985 and one on September 17, 1985. In addition, Mr. Pyatt's records reflect a breakfast with Mr. Nofziger on October 13, 1983; two other meetings with Mr. Nofziger in 1983; seven meetings with Mr. Bragg in 1984 and 1985; attendance at three anniversary celebrations of the Nofziger and Bragg firm in 1984, 1985, and 1986; and more than sixty telephone calls with Messrs. Nofziger and Bragg over a two year period.
[63] Hearing Record, Part 2 at 157–58.

indicate that Mr. Pyatt had lunch with them on at least two occasions more than six months earlier—on July 19, 1985 and September 17, 1985. There is strong evidence that Mr. Pyatt continued to discuss business with Mr. Bragg in this period: the telephone logs provided by Mr. Pyatt's office show more than fifty telephone calls between Mr. Pyatt and Mr. Bragg spread throughout 1985. In addition, an August 8, 1985 note to Mr. Pyatt from his deputy specifically discusses Mr. Bragg's continuing interest in Wedtech.

Finally, Mr. Pyatt acknowledged that he attended an inaugural ball as a guest of Messrs. Nofziger and Bragg in January 1985. Mr. Pyatt stated that he did not ask Mr. Nofziger or Mr. Bragg whether they represented defense contractors prior to attending the ball as their guest:

Senator LEVIN. [Mr. Wallach has] told the Subcommittee that he met with you on at least one occasion, and that was at a ball commemorating the President's second inaugural, and that you were present at that ball as a guest of Mr. Nofziger and Mr. Bragg. Is that true?

Mr. PYATT. Yes.

* * * * * * *

Senator LEVIN. . . . And why would you have been invited by them to the ball? Were they friends of yours?

Mr. PYATT. I do not know why they invited me. I went to the inaugural ball.

Senator LEVIN. Before you went, did you ask them whether they were representing defense contractors?

Mr. PYATT. No, I did not.[64]

c. The White House Role. —Mr. Moreno also told the Subcommittee staff that Wedtech was assisted in its efforts to get the pontoon contract by Mr. Wallach. According to Mr. Moreno, Mr. Wallach contacted "his friend"—whom Mr. Moreno said he presumed to be Edwin Meese III, then the counselor to the President—about the pontoon contract on several occasions. On one of these occasions, Mr. Moreno stated, Mr. Wallach said that his friend had called Mr. Weinberger—apparently a reference to the Secretary of Defense—on behalf of Wedtech.

Mr. Moreno's allegations are partially supported by the statements of Mr. Wallach himself in his interview with the Subcommittee staff. In his interview, Mr. Wallach confirmed that he discussed Wedtech with Mr. Meese in the period of the pontoon contract and that he "could have" mentioned specific problems that Wedtech was encountering:

SUBCOMMITTEE STAFF. Again, just to clear this up, your conversations, your meetings with Mr. Meese continued after the period of the Army contract that we discussed before, is that correct?

[Nods head.]

SUBCOMMITTEE STAFF. Did the subject of Wedtech ever come up again?

Mr. WALLACH. Yes.

SUBCOMMITTEE STAFF. Do you remember anything specifically about what might have come up about Wedtech?

Mr. WALLACH. No. It would have been in the context of casual conversation about what I was doing with my life. . . . It was never very extensive, it was never terribly detailed.

SUBCOMMITTEE STAFF. Would you have mentioned specific problems or would you have mentioned specific problems that Wedtech was encountering?

Mr. WALLACH. Yes, I could have.

SUBCOMMITTEE STAFF. Do you remember anything specifically?

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[64] Hearing Record, Part 2 at 159.

Mr. WALLACH. No. I can't tell you, though, that I never groused about a problem or expressed a frustration with something that was going on.[65]

Mr. Moreno's claim that Mr. Wallach discussed the pontoon contract with Mr. Meese is also supported by an October 18, 1984, memorandum in which Mr. Wallach invited Mr. Meese to the launching of the first Wedtech pontoon. This memorandum to Mr. Meese contains casual references to both Wedtech and "pontoons".

On the other hand, the Subcommittee has found no evidence to support Mr. Moreno's report that Mr. Meese contacted the Secretary of Defense on behalf of Wedtech. Mr. Meese has stated through his attorney that he had no involvement at all in the pontoon contract. Mr. Weinberger has told the Subcommittee that he had "no knowledge of anything connected with this company [Wedtech] or with the [Navy pontoon or Army engine] contracts." He further stated that he had never discussed these matters with Mr. Meese.[66] In short, although Mr. Wallach may have told Wedtech officials that "his friend" had called Mr. Weinberger about the pontoon contract, the Subcommittee has found no corroborating evidence that Mr. Meese in fact did so.

3. DISCUSSION AND FINDINGS

a. The Merits of the Decision.—In mid-1983 a number of 8(a) companies learned of a potential $200 million Navy pontoon contract and contacted SBA and Navy officials to pursue the requirement. The Navy initially rejected these efforts and declined to set aside the contract for performance by an 8(a) company. On December 8, 1983, Assistant Secretary Pyatt reversed his initial decision and agreed to set aside the non-motorized portion of the pontoon contract. A month later, on January 6, 1984, Mr. Pyatt changed his mind again and agreed to set aside the entire contract.

Uniformed Navy officials responsible for the pontoon contract resisted this decision on the grounds that the program was too big, too complex, and too time-sensitive to trust to an inexperienced 8(a) company. These Navy officials believed that existing, idle shipyards were capable of performing the work and expressed a preference for competitive procurements. Mr. Pyatt himself recognized in contemporaneous documents that the Navy's operational need for the pontoons was critical; he acknowledged in testimony before the Subcommittee that the set-aside of the contract added an element of risk.

Mr. Pyatt's decision to set aside the contract, and ultimately to accept Wedtech as the contractor, was made with full awareness that the pontoon program was a vital component of the new Rapid Deployment Force. It was made with full knowledge that a delay in the delivery of the pontoons could severely undermine the United States' ability to respond with force in crisis situations around the world. And it was made in the face of warnings from the uniformed Navy that a disadvantaged business was highly unlikely to have facilities in place and would not be able to meet the Navy's critical delivery schedule. *The Subcommittee finds that the Navy*

[65] Transcript of June 29, 1987 interview of Mr. Wallach at 206–07.
[66] October 2, 1987 Statement of Secretary Weinberger to the Subcommittee.

decided to set aside the pontoon contract despite the belief of officials responsible for administering the contract that this decision would result in late delivery and have a detrimental impact on the national defense.

b. The Reasons for the Decision.—Mr. Pyatt testified that he changed his mind and decided to set aside the pontoon contract because (a) the Navy had goals for contracting with disadvantaged businesses to meet; and (b) SBA Administrator James Sanders had argued persuasively that it would be a good idea to establish an 8(a) firm in the metal-working business. Mr. Pyatt further testified that his decision was not influenced by pressure from Wedtech or its consultants and that in fact he felt no such pressure.

There is no Navy documentation indicating that Mr. Pyatt relied upon his stated reasons when he decided to set aside the contract. Mr. Pyatt's explanation of his decision is undermined by the testimony of other witnesses and by Mr. Pyatt's own inconsistent statements on the subject.

(1) Mr. Pyatt testified that he decided to set aside part of the pontoon contract on December 8, 1983, as result of the case made by Mr. Sanders. Later, however, Mr. Pyatt testified that he did not discuss the pontoon contract with Mr. Sanders until after December 8th.

(2) Mr. Pyatt testified that Admiral Hughes did not make the set-aside "a big issue". However, Admiral Hughes testified that he argued against the decision and was "surprised" and "disappointed" when Mr. Pyatt went ahead with the set-aside.

(3) Mr. Pyatt testified that the sole source of pressure on him to set aside the pontoon contract came from the Navy's 8(a) quotas. However, statistics provided by Mr. Pyatt's office indicate that the Navy would have exceeded its FY 1984 goals by almost 10% even without the set-aside of the pontoon contract.

(4) Mr. Pyatt testified that he called a January 19, 1984, meeting to allow the uniformed Navy an opportunity to "air issues" about the set-aside. However, Mr. Pyatt acknowledged that he had already sent a letter to the SBA in which he agreed to offer the pontoon contract for set-aside.

Other evidence raises questions about Mr. Pyatt's testimony that political pressure played no role in his decision-making. A Navy memorandum of the January 4, 1984 meeting at which Mr. Pyatt first announced his decision to set aside the entire pontoon contract states that the decision "was reportedly influenced by political pressure brought to bear on ASN [Mr. Pyatt]." Moreover, several file memoranda written by Wedtech consultant E. Robert Wallach in November and December 1983 indicate that Mr. Pyatt had decided to set aside the contract and that Wedtech would be a primary recipient; Wedtech officials have told the Subcommittee that their consultants were in regular contact with Mr. Pyatt and knew this decison would be forthcoming months before Mr. Pyatt officially informed the SBA of the set-aside.

There is strong evidence that Wedtech consultants Lyn Nofziger and Mark Bragg were lobbying on behalf of Wedtech. Mr. Pyatt expressly denied that he spoke to Messrs. Nofziger and Bragg prior to the award of the pontoon contract, but questions are raised about this denial by Wedtech documents, documents from Mr. Pyatt's

own files, by inconsistencies in Mr. Pyatt's own statements, and by the statements of other witnesses.

(1) Mr. Pyatt testified that he believed he first talked to Messrs. Nofziger and Bragg some time *after* the award of the contract. However, Mr. Pyatt's office calendar indicates that he met with Mr. Nofziger on several occasions *before* the set aside or award of the pontoon contract, including attendance of an anniversary party for the Nofziger and Bragg firm.

(2) Former Navy Secretary John Lehman told the Subcommittee staff that he met with Mr. Nofziger about the pontoon contract and assumes that he referred Mr. Nofziger to Mr. Pyatt as the official responsible for the set-aside decision.

(3) A NAVFAC memorandum two months prior to the contract award stated that "Mr. Nofziger . . . President's Political Advisor" had placed a telephone call to Mr. Pyatt's office on behalf of Wedtech.

(4) An unsigned November 1, 1983 memorandum from the Assistant Secretary's files is identical to a document found in Wedtech's files, bearing the handwriten notation—"Mario, this is the piece that Lyn and Mark will be using with SBA and Navy. Steve."

(5) In an interview with the Subcommittee staff, Mr. Wallach stated that his information about Mr. Pyatt's decisions came from Mr. Bragg, whom he understood to be in regular contact with Mr. Pyatt in the period before the contract was awarded.

(6) Former Wedtech Executive Vice President Mario Moreno has told the Subcommittee in a sworn affidavit that Mr. Bragg reported on regular conversations with Mr. Pyatt in the period before the contract was awarded.

(7) Mr. Pyatt acknowledged that he initiated a telephone call to Mr. Bragg to discuss Wedtech's performance of the pontoon contract soon after it was awarded, but said he did not know how he knew that Messrs. Nofziger and Bragg represented Wedtech.

Despite extensive questioning about his relationship with Messrs. Nofziger and Bragg in his testimony before the Subcommittee and in two interviews with the Subcommittee staff, Mr. Pyatt failed to disclose the full scope of this relationship. In response to a post-hearing question from the Subcommittee, Mr. Pyatt provided the Subcommittee with pages from his office calendars reflecting contacts with Messrs. Nofziger and Bragg. From these documents, the Subcommittee learned for the first time that Mr. Pyatt had a breakfast and two other meetings with Mr. Nofziger in 1983; seven meetings with Mr. Bragg in 1984 and 1985; at least two lunches with Mr. Nofziger in 1985 and 1986; attended three anniversary celebrations of Nofziger and Bragg Communications. In addition, Mr. Pyatt provided the Subcommittee with phone logs beginning in August 1984, which indicated that he spoke to Messrs. Nofziger and Bragg on the telephone on at least sixty other occasions in 1984, 1985 and 1986.

Mr. Pyatt's statements about his relationship with Messrs. Nofziger and Bragg after the award of the contract also contained contradictions.

(1) Mr. Pyatt testified that he last talked to Mr. Bragg about Wedtech in "early '84". However, Mr. Pyatt's office calendars reflect more than 50 telephone calls and meetings with Mr. Bragg in

1985 and 1986, with the last telephone calls taking place in July 1986. According to Wedtech officials, Mr. Bragg claimed to have discussed the pontoon contract extensively with Mr. Pyatt in this period.

(2) Mr. Pyatt told the Subcommittee staff that he discussed his nomination with Mr. Nofziger prior to his confirmation by the Senate. In his testimony before the Subcommittee, Mr. Pyatt first denied that this conversation took place at all. When reminded of his earlier statement to the staff, Mr. Pyatt stated that the conversation took place after his confirmation.

(3) Mr. Pyatt testified that he agreed to have lunch with Messrs. Nofziger and Bragg only after a specific statement from Mr. Bragg that he no longer represented defense contractors at all. In fact, Mr. Pyatt had at least two lunch meetings with Messrs. Nofziger and Bragg during the period when they were actively working for Wedtech.

(4) Mr. Pyatt testified that he attended the inaugural ball as a guest of Messrs. Nofziger and Bragg in January 1985, at about the time of key Navy decisions regarding the 1985 pontoon options.

The Subcommittee finds that Mr. Pyatt's testimony about his actions and rationales for agreeing to set aside the pontoon contract for Wedtech contains serious inconsistencies and contradicts relevant documents, warranting further investigation.

These inconsistencies and contradictions, coupled with Mr. Pyatt's inability satisfactorily to explain his relationship with Messrs. Nofziger and Bragg, as well as the lack of any documents in Navy files explaining Mr. Pyatt's sudden reversal and decision to set-aside the contract, lead the Subcommittee to conclude that Mr. Pyatt was in fact influenced in his decision to set aside the pontoon contract by Wedtech lobbyists. *Accordingly, the Subcommittee finds that the Navy agreed to set aside the pontoon contract at least in part because of pressure from Wedtech's well-connected consultants.*

c. The Appearance of Impropriety.—Mr. Pyatt attended several lunches at the offices of Wedtech consultants Lyn Nofziger and Mark Bragg. Mr. Pyatt testified that he attended these lunches only after being told by Mr. Bragg that he no longer represented any defense contractors. However, Mr. Pyatt testified he did not ask a similar question of Mr. Nofziger. Moreover, the office calendars of Messrs. Nofziger and Bragg reflect lunches with Mr. Pyatt in July and September 1985. During this period, Mr. Pyatt had frequent telephone contacts with Mr. Bragg and received at least one memorandum reflecting Mr. Bragg's continuing interest in Wedtech.[67] Mr. Pyatt has stated that he may have paid, or at least attempted to pay, for these lunches.[68]

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[67] August 8, 1985 handwritten note from Mr. Arny to Mr. Pyatt.
[68] February 25, 1988 Report of the Inspector General of the Department of Defense.

In addition, Mr. Pyatt attended the 1985 inaugural ball as a guest of Messrs. Nofziger and Bragg. Mr. Pyatt testified that he did not ask whether they represented defense contractors before accepting this invitation. He has also stated that he did not pay or attempt to pay for these tickets, which have been valued at $100.[69] Finally, Mr. Pyatt's office calendars indicate that he attended three separate parties given by Messrs. Nofziger and Bragg to commemorate anniversaries of their lobbying firm.

Executive Order 11222 prohibits an employee of any executive branch agency from accepting anything of monetary value from an organization or person who contracts with his or her agency.[70] Under a long-standing interpretation of this Order by the Office of Government Ethics (OGE), this rule prohibits the acceptance of a "one-on-one" meal from a contractor representative or agent.[71] The Executive Order authorizes federal agencies to adopt such exceptions to this rule as are necessary and appropriate to their work. However, none of the exceptions adopted by the Department of Defense of the Department of the Navy appears applicable to a private luncheon, not associated with any official event, in the offices of a contractor consultant.[72]

Mr. Pyatt's acceptance of a free ticket to the inaugural ball from Messrs. Nofziger and Bragg also appears to have violated Executive Order 11222. The Subcommittee has learned that the issue of tickets to the inaugural ball was discussed between OGE and the White House counsel in early 1985. According to OGE, the agency determined that a free ticket to an inaugural ball was a gift that should be disclosed in personal financial disclosure forms at face value, regardless of whether the donor of the ticket paid less for it or even obtained it free. Mr. Pyatt did not report on his financial disclosure forms that he had attended the inaugural ball as a guest of Messrs. Nofziger and Bragg.

Regardless of whether Mr. Pyatt in fact violated the Executive Order or the financial disclosure requirements of the Ethics Act,[73] his attendance of lunches, anniverrsary parties and the inaugural ball as the guest of a defense contractor consultant is particularly troublesome in light of the fact that Mr. Pyatt's office reached a number of very important and questionable decisions favorable to Wedtech in the periods immediately before and after these events. Navy regulations specifically state that Navy personnel shall "[a]void any action, whether or not specifically prohibited, which might result in or reasonably be expected to create the appearance of . . . [l]osing complete independence or impartiality." [74] Department of Defense directive 5500.7 contains a similar requirement.[75]

Mr. Pyatt failed to live up to this standard in his relationship with Messrs. Nofziger and Bragg. The Inspector General of the Department of Defense has found that, whether or not Mr. Pyatt paid

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[69] February 25, 1988 Report of the Inspector General of the Department of Defense.
[70] Executive Order 11222, Section 201.
[71] *See* October 23, 1987 OGE Memorandum on Acceptance of Food and Refreshments by Executive Branch Employees (reaffirming OGE's "long-standing interpretation" of E.O. 11222).
[72] 32 C.F.R. Part 40 (Department of Defense); 32 C.F.R. Part 721 (Department of the Navy).
[73] *See* 5 C.F.R., Part 735.
[74] 32 C.F.R. 721.18.
[75] Department of Defense Directive 5500.7, Paragraphs VI.D., VI.F.

for his lunches with Messrs. Nofziger and Bragg, he violated directive 5500.7 by "creating the appearance of losing independence or impartiality, as well as creating the appearance of adversely affecting the confidence of the public in the integrity of the Government." [76] *The Subcommittee finds that Mr. Pyatt's attendance at lunches and anniversary parties and the inaugural ball as the guest of Messrs. Nofziger and Bragg created at a minimum the appearance of impropriety.*

[76] February 25, 1988 Report of the Inspector General of the Department of Defense.

D. The Award of the Pontoon Contract to Wedtech

1. Wedtech's efforts to influence the SBA

a. *Wedtech's Competitors.*—Wedtech was not the only 8(a) company actively to pursue the pontoon contract in the fall and winter of 1983. Univox Corp. was the first to seek the contract when Senators Paul Laxalt and Chic Hecht of Nevada wrote the SBA on its behalf in mid-June 1983. Lee Engineering of San Francisco, Medley Tool & Die of Philadelphia, and Universal Canvas of Corpus Christi Texas contacted the SBA and the Navy in September 1983. Other companies, including a Texas joint venture, several Puerto Rican companies, and Wedtech, joined the contest later in the fall.

Former SBA Associate Administrator Henry Wilfong testified that if the SBA had operated within usual rules and procedures, the pontoon contract would have been awarded to Univox of California, the first 8(a) company to seek the contract.[1] According to Mr. Wilfong, the SBA Administrator and his staff did not allow Mr. Wilfong's Minority Small Business Office to follow the normal rules and procedures:

> Mr. Wilfong. . . . [W]e were not allowed to put it to bed. We were not allowed to select the company on the West Coast as the contractor. . . . [A]fter a meeting of the Regional Administrators, I was told that this was too large for any one contractor and should be spread around. It is interesting to me that Wedtech ended up being the one contractor, when that was contrary to the stated purpose.[2]

Mr. Wilfong stated that he was "told to tell [Univox] not to make waves" about the fact that the contract was going to Wedtech, because a second phase of pontoon production would be made available to Univox or other contractors on the West Coast.[3] Univox, however, believed that there would be no sharing of the contract because the whole thing had been rigged for Wedtech:

> Mr. Wilfong. . . . [Univox President John Grayson] indicated to me that he had heard that the fix was on, and that there was not going to be a sharing of the contract, that there was not going to be a second phase that would go to the West Coast, but that Wedtech would end up getting all the contract, and that Lyn Nofziger was the person who had been primarily involved with that, and that he, Nofziger, had indicated evidently to Grayson that Grayson had no chance of winning that contract.[4]

Lee Engineering, the second candidate for the contract, underwent a similar experience. Lee's activities in the fall and winter of 1983 indicate the depth of the efforts made by Wedtech's competitors in pursuit of the pontoon contract. As Lee engineering attorney J. Dennis McQuaid, told the Subcommittee in an affidavit that

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[1] Hearing Record, Part 2 at 41-42.
[2] Hearing Record, Part 2 at 44.
[3] Hearing Record, Part 2 at 44, 51.
[4] Hearing Record, Part 2 at 44.

is supported by interviews with company President Frank Lee and consultant Joe Zuke:

(1) Lee contacted SBA Administrator James Sanders, Deputy Associate Administrator Robert Saldivar, San Francisco Regional Administrator Irene Castillo, and Navy Small Business director Richard Ramirez in the fall and winter of 1983. Lee was encouraged by all of these officials to pursue the contract.

(2) Lee established joint ventures in San Francisco and Puerto Rico to ensure that it would have adequate facilities and expertise to build pontoon causeways for delivery on either coast, as required by the contract specifications.

(3) Lee contacted former Puerto Rican Governor Luis A. Ferre, White House staffer Rick Neil, and the Chief of Staff of California Senator Pete Wilson, all of whom supported and encouraged Lee's efforts to obtain the contract.[5]

According to Mr. McQuaid and Mr. Zuke, Lee Engineering was encouraged by SBA officials to pursue the contract as late as January 9, 1984—just two weeks before the SBA officially selected Wedtech as its candidate for the contract. Irene Castillo, the former San Francisco Regional Administrator, stated in an interview with the Subcommittee staff that the SBA Administrator's office promised her that Lee Engineering would get a fair shot at the contract and that she would play a role in the decision-making process.

In mid-January, however, the SBA central office decided not to award any portion of the contract to Lee. Ms. Castillo told the Subcommittee that officials in the Washington office "left [her] out in the cold," failing to inform her why Lee Engineering had suddenly been dropped from consideration. From that time on, Mr. McQuaid reports, "telephone calls with the regional office proved unproductive as that office clearly was not being kept informed of the decision-making process with regard to this 8(a) requirement." [6] According to Mr. McQuaid's affidavit, Lee's expenditures on the contract—encouraged by the SBA—contributed to the ultimate bankruptcy of the company.[7]

Former Wedtech Executive Vice President Mario Moreno has told the Subcommittee staff that Wedtech took direct action to undermine the efforts of its competitors for the pontoon contract. According to Mr. Moreno, Wedtech's actions included the following:

(1) Puerto Rican companies. Wedtech arranged a meeting with former Puerto Rican Governor Ferre through the offices of Raphael Capo, who had previously served as an aide to Vice President Bush. Governor Ferre spent almost two days with Wedtech officials in Puerto Rico and later came to New York to see the company. According to Mr. Moreno, Governor Ferre never supported Wedtech for the contract, but softened his support for other companies as a result of this lobbying.

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[5] Affidavit of Mr. McQuaid, Attorney for Lee Engineering, at 2–5. Copies of a Puerto Rican joint venture agreement witnessed by former Governor Ferre and a memorandum from Richard Ramirez to Assistant Secretary Pyatt reflecting a meeting between Gov. Ferre and Vice President Bush about the contract have been obtained by the Subcommittee from SBA and Navy files.

[6] Affidavit of Mr. McQuaid at 5.

[7] Affidavit of Mr. McQuaid at 5–6.

(2) Texas and New Mexico companies. One Texas joint venture was pushed by Jesse Quigley, an SBA official who had worked closely with Wedtech in its efforts to get the Army engine contract. According to Mr. Moreno, he and other Wedtech officials invited Mr. Quigley to New York and promised him that the joint venture he supported would get some subcontract work if Wedtech received the contract. Mr. Moreno stated that a similar arrangement was made with a second Texas company—after Wedtech had hired away the company's leading consultant and political contact.

(3) Pennsylvania companies. According to Mr. Moreno, Wedtech believed that the SBA was "almost controlled from Philadelphia, not Washington." For this reason, Wedtech agreed to split the contract with Medley Tool and Die, a Philadelphia company. In fact, the SBA named Wedtech and Medley as its contractors, and the two companies had already begun negotiations over how to split the contract when Medley was suddenly dropped from consideration. The negotiations between Wedtech and Medley are further described below.

With regard to Wedtech's other competitors, Mr. Moreno stated that Wedtech had too much influence and acted too quickly for them to respond. Wedtech simply out-maneuvered the other candidates for the contract and "pulled the rug out from under them in one day." As Mr. Moreno explained, "It was too sudden for anybody to do anything to us, especially since it happened over the holidays." SBA officials deny that they were subject to any improper influence.

b. Direct Contacts with the SBA.—Wedtech contacted several SBA officials directly to seek their assistance in pursuing the pontoon contract. According to Mr. Moreno, these SBA officials included former Administrator James Sanders, former New York Regional Administrator Peter Neglia, and former Deputy Associate Administrator Robert Saldivar.

First, Mr. Moreno stated that he and Wedtech attorney Bernard Ehrlich met with Mr. Neglia on numerous occasions and that Mr. Neglia actively assisted Wedtech in its efforts to obtain the pontoon contract. In the course of his meetings with Mr. Neglia, Mr. Moreno stated, Mr. Neglia reported on conversations with Mr. Sanders and Philadelphia Regional Administrator Peter Terpuluk, who, he said, agreed that the contract would be shared by Wedtech and a Philadelphia company.[8]

Second, Mr. Moreno stated that Wedtech lobbyist Mark Bragg contacted Mr. Sanders directly to push Wedtech's candidacy.[9] In a letter responding to post-hearing questions from the Subcommittee, Mr. Sanders stated that he does not recall any such contact with Mr. Bragg, but did not deny that such a contact could have taken place:

> I do not recall any contacts from Nofziger or Bragg about Wedtech after September, 1982, but on the other hand, it would have been normal to hear from a representative of any large 8(a) firm if a large contract was made available to the 8(a) program.[10]

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[8] Affidavit of Mr. Moreno, Paragraph 9.
[9] Affidavit of Mr. Moreno, Paragraph 5.
[10] September 22, 1987 letter from Mr. Sanders to the Subcommittee.

There are other indications that political pressure may have been placed on the Administrator's office with regard to this contract. First, the SBA's Assistant District Director in New York, Hank Diaz, told the Subcommittee staff that he heard a rumor that Wedtech might be getting a large Navy contract, so he asked an official in the Regional Office about it. According to Mr. Diaz, he was told to "hush up because it was coming from the top." Second, Navy notes on a January 20, 1984 telephone call with an unnamed SBA official state: "SBA said that the biggest political guns ever seen would seek multiple contractors." (At the time, the SBA was planning to split the contract between Wedtech and Medley). Third, according to Wedtech minutes of a meeting with SBA officials two weeks later, Mr. Sanders' Chief of Staff—Robert Luhlier—opened the meeting by noting the "political blood" that had been shed over the contract:

> Mr. LUHLIER. The purpose of the meeting is to discuss the technical and distribution aspects of the project. A lot of political blood has been shed. The S.B.A. and the firms have a good opportunity. Single largest long-term procurement, and the Administrator is committed to seeing this work.[11]

In an interview with the Subcommittee staff, Mr. Luhlier acknowledged that "Wedtech was on the forefront in marketing, chomping at our heels to get this thing moving." When asked who at Wedtech was "chomping at the SBA's heels," Mr. Luhlier explained that the New York Regional SBA Administrator, Peter Neglia, repeatedly contacted the Administrator's office to push Wedtech's case. Mr. Luhlier stated that he was not aware of pressure from any other source.

Wedtech lobbyist E. Robert Wallach, at least, appears to have believed that Wedtech was successful in influencing Mr. Sanders. In a December 7, 1983 file memorandum, Mr. Wallach stated his belief that the Navy would set forth specifications for the pontoon contract that only Wedtech could meet. He concluded:

> The answer then is to get a letter back to the SBA specifying Wedtech and apparently Sanders has already decided to do that.

Mr. Moreno told the Subcommittee that Wedtech lobbyist Stephen Denlinger contacted SBA Deputy Associate Administrator Robert Saldivar about Wedtech's efforts to obtain the pontoon contract.[12] Mr. Moreno stated that he met with Mr. Saldivar himself on at least two occasions while the pontoon contract was pending and that Mr. Saldivar helped Wedtech fight off other companies' efforts to get the contract.

Mr. Saldivar acknowledged in testimony before the Subcommittee that he met with Mr. Denlinger and with Wedtech officers about the pontoon contract in late 1983 and early 1984.[13] However,

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[11] "SBA Meeting at Washington, D.C. February 8, 1984". In his testimony before the Subcommittee, Mr. Sanders stated that he did not know what Mr. Luhlier meant by this statement. He speculated that the "political blood-shedding" statement might have referred to the fight between Wedtech and Medley over how to divide the contract:

> Mr. SANDERS. . . . I do recall that there was a lot of gnashing going on between Medley and Wedtech, which was not unusual. These 8(a) firms used to chew each other up to try and get a contract and they would cast aspersions on one another. They would try fighting for a contract in front of us.

Hearing Record, Part 1 at 150.

[12] Affidavit of Mr. Moreno, Paragraph 10.

[13] Hearing Record, Part 2 at 59.

Mr. Saldivar denied in his prepared testimony that he played any role in the selection of Wedtech for the pontoon contract.[14] Under questioning from members of the Subcommittee, Mr. Saldivar acknowledged that he "may have indicated" to SBA officials responsible for the selection of a contractor that Wedtech was one of the stronger candidates.[15] In fact, Mr. Saldivar signed a letter granting Wedtech a three-year 8(a) extension on the same day—January 25, 1984—that he attended a meeting at which Wedtech was presented as the SBA's candidate for the pontoon contract.

Mr. Saldivar also testified that he discussed Wedtech and the pontoon contract with Richard Ramirez of the Navy.[16] Mr. Saldivar's conversation with Mr. Ramirez about the pontoon project caused consternation among other SBA employees, who felt that Mr. Saldivar was working on "his own agenda". Joe Bennett, a special assistant in the 8(a) office, stated in an interview with the Subcommittee staff that he remembered Mr. Saldivar taking several trips to the Navy's offices, infuriating Associate Administrator Henry Wilfong, who was not informed of these trips by Mr. Saldivar.[17] All of this took place *before* a February 24, 1984 SBA memorandum that officially assigned Mr. Saldivar to the project.[18]

Several pieces of evidence indicate that Mr. Saldivar may have played a greater role in assisting Wedtech than he has acknowledged.

First, Mr. Saldivar admitted in his testimony before the Subcommittee that Wedtech offered him a substantial sum of money while he was still employed by the SBA and that—although he did not accept the money—he failed to report this offer to the responsible authorities. Mr. Saldivar testified that Mr. Denlinger offered him $12,000 on behalf of "his friends" at Wedtech.[19] As Mr. Saldivar explained:

> Mr. SALDIVAR. . . . [I]n the course of a conversation, Mr. Denlinger indicated, "You know, you've done an awful lot for a number of companies, and a lot of the people really feel a lot of gratitude for your accomplishments. And they'd like to be able to give you a gift for your many contributions."[20]

Mr. Saldivar admitted that he failed to report this offer to the SBA Inspector General as required by the agency's regulations.[21]

Second, files obtained from Wedtech consultant E. Robert Wallach indicate Wedtech's desire to facilitate promotions for Mr. Saldivar, and there is evidence that Wedtech was successful in this endeavor. On February 21, 1984, Mr. Wallach wrote a file memorandum in which he indicated that the assignment of Mr. Saldivar to work on the pontoon project would be helpful to Wedtech:

> Discussion of the causeway contract. Emphasis upon competency of Robert Saldovar [sic]. Number 2 person in the 8a program in Washington, D.C., serving under

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[14] Prepared Testimony of Mr. Saldivar at 3.
[15] Hearing Record, Part 2 at 62–63.
[16] Hearing Record, Part 2 at 60, 61.
[17] *See* Hearing Record, Part 2 at 46–47 (Testimony of Mr. Wilfong).
[18] February 24, 1984 memorandum from Mr. Romain to Mr. Bennett.
[19] Hearing Record, Part 2 at 65–69.
[20] Hearing Record, Part 2 at 68.
[21] Hearing Record, Part 2 at 67. Mr. Saldivar acknowledged that he viewed the offer as "irregular," but stated that "obviously, in the SBA programs there have been a number of times when people indicate their interest of doing something for an individual working on this program."

Wolfong [sic]. (Saldovar was very instrumental in opposing Keenan on other matters.) Causeway contract should be reassigned from Joe Bennett to Saldovar.

If there is an opening in the top slot in the 8a position at SBA, Saldovar is the man. Transfer of the causeway contract to him would facilitate and guarantee its efficient undertaking without bias.

Three days later, an SBA memorandum indicates that Mr. Saldivar was in fact assigned to work on the pontoon project.[22]

In a March 3, 1984, file memorandum, Mr. Wallach wrote that it would be in Wedtech's interest if Mr. Saldivar were to replace Henry Wilfong as Associate Administrator for Minority Small Business.

Saldovar [sic] has been offered a position in San Francisco with the SBA, which he would very much like to have. This will, however, remove him from Washington and so leave the Washington office entirely in control of the people from California and Pittsburgh. He would stay in Washington if he could have Wilfong's position, which would require Wilfong moving up.[23]

In August, the Washington Post reported that Mr. Sanders had shifted Mr. Wilfong's responsibilities to Mr. Saldivar. At that time, Mr. Sanders stated that the change was being made because Administration goals for the 8(a) program were not being met.[24] Mr. Wilfong told the Subcommittee staff that he understood he was being pushed aside so that more contracts could be awarded to Hispanic firms; he stated that it was only later that he came to believe that Wedtech's influence had played a role.

Finally, on October 10, 1984, Wedtech officials sent a copy of Mr. Saldivar's resume to Mr. Wallach; nine days later, Mr. Saldivar was appointed to a new position as chief of the Navy's small business office. Mr. Saldivar acknowledged that he "may have discussed my desire to make" career moves with Wedtech personnel, but claimed that he did not know Mr. Wallach and had no idea how Mr. Wallach could have gotten a copy of his résumé.[25]

2. THE SBA SELECTION PROCESS

a. The Selection of Wedtech and Medley.—The SBA Standard Operating Procedures effective at the time of the pontoon set-aside states that 8(a) subcontractors are to be selected on the basis of such factors as technical capability, financial capacity, and ability to comply with required delivery or performance schedules.[26] Where consistent with these factors, a contract was supposed to be reserved for the firm that initially identified the requirement.[27]

The first 8(a) firm to identify the pontoon causeways as a potential contracting opportunity was not Wedtech, but Univox, which sought the contract in the Summer of 1983. However, the SBA does not appear to have made any effort to determine whether Univox was technically and financially capable of performing the contract. As former Associate Administrator Henry Wilfong testified, the SBA failed to focus the selection process on Univox in accordance with the Standard Operating Procedures. Instead, other companies

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[22] February 24, 1984 memorandum from Mr. Romain to Mr. Bennett.
[23] March 3, 1984 memorandum from Mr. Wallach to Wedtech files, at 3.
[24] *Washington Post* August 28, 1984, The Federal Report.
[25] Hearing Record, Part 2 at 64.
[26] SBA Standard Operating Procedures, Paragraph 64(a).
[27] SBA Standard Operating Procedures, Paragraph 59(a).

were brought in as candidates for the contract, including some that applied to SBA after Univox and some—like Wedtech—that never formally applied at all.

SBA officials, including Mr. Sanders, state that they brought in other candidates because they wanted to divide the pontoon contract among several 8(a) contractors.[28] Mr. Sanders explained in his testimony before the Subcommittee that he planned to have 8(a) firms working on the contract on the East Coast, the West Coast, the Gulf Coast, and possibly on the Great Lakes.[29] This plan was confirmed by Mr. Sanders' then-Chief of Staff, Robert Luhlier, who told the Subcommittee staff that the Administrator was concerned by the size and visibility of the contract and by the risk that the 8(a) company selected would fail to perform. According to Mr. Luhlier, "The strategy was developed to have several 8(a)'s to spread the risk so that if one did go under, it would not be a total loss."

In the fall of 1983, two Special Assistants from the SBA's Office of Minority Small Business—Joe Bennett and Aubrey Rogers—were assigned to assess candidates for the pontoon contract.[30] Mr. Luhlier stated that Mr. Bennett and Mr. Rogers were assigned "not to make the selection, but to come up with candidates." Mr. Bennett and Mr. Rogers told the Subcommittee staff that they called upon all of the SBA's regional offices to nominate contractors with the potential to build pontoon causeways. Using documentation provided by the regional offices—including financial statements, capability statements, and facilities descriptions—they assessed these candidates. According to Mr. Bennett, "We wanted to make sure that the 8(a)'s would perform. This was our chance to show that they could do it."

Mr. Bennett and Mr. Rogers did not have any clear recollection as to how long this review process took. Eventually, they came up with a list of about eight or ten firms, including Wedtech, that they believed to be capable of performing on the pontoon contract. At this time, both Mr. Bennett and Mr. Rogers believed that the contract would be divided up among several of the candidates. As Mr. Bennett explained in his interview with the Subcommittee staff, a second contractor would provide the SBA with "a backup system." The SBA wanted to prove to the Department of Defense that 8(a) companies could perform important contracts, Mr. Bennett stated, and "[w]hen you have a project that is that important you don't put all of your eggs in one basket." Mr. Bennett added that it was also a bad idea to give the entire contract to a single contractor, because the contract was so large it was "a building block that could be used for several companies." Mr. Bennett stated that the SBA had no interest in building up a single giant company.

When a selection was finally made in January 1984, Wedtech and Medley (a Pennsylvania company) were named to perform virtually all of the work. Despite the fact that the pontoon contract was the largest 8(a) contract ever awarded, no rationale for this se-

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[28] Hearing Record, Part 1 at 133 (Testimony of Mr. Sanders); Hearing Record, Part 2 at 44 (Testimony of Mr. Wilfong); Hearing Record, Part 1 at 67 (Testimony of Mr. Rogers).

[29] Hearing Record, Part 1 at 149.

[30] Hearing Record, Part 2 at 45 (Testimony of Mr. Wilfong); *id.* at 53 (Testimony of Mr. Saldivar).

lection was documented by the SBA.[31] In his testimony before the Subcommittee, Mr. Sanders acknowledged that this lack of documentation was highly unusual:

Senator LEVIN. We looked at both the central office files as well as the New York regional and the district office files and we have been unable to find a single document which explains or justifies the SBA decision to select Wedtech for the pontoon contract. Can you explain why there was never a memorandum or other document which explains or justifies the decision to give that contract ultimately to Wedtech alone?

Mr. SANDERS. I sure as hell cannot.

Senator LEVIN. Would that be in accordance with SBA's usual procedures?

Mr. SANDERS. Yes, it would, to have a file on that subject.

Senator LEVIN. In other words, the usual procedure was that there would be a written memorandum; is that correct?

Mr. SANDERS. Of course.[32]

SBA officials provided contradictory explanations of the agency's failure to name other 8(a) companies to share in the contract. Mr. Sanders testified that Wedtech was selected because it was the only 8(a) company qualified for the contract.[33] However, this testimony is inconsistent with the statements of Mr. Bennett and Mr. Rogers that they developed a list of eight or ten firms capable of delivering pontoons. There was, to give one example, never any SBA finding that Lee Engineering was *not* capable of delivering the pontoons. When the SBA needed to find a second source for pontoons in 1985, it quickly nominated Bay City Marine of San Diego, California. Bay City, which was found by Navy officials to be "far superior" to Wedtech,[34] does not appear to have even been considered by the SBA when it chose Wedtech in 1983.

Mr. Luhlier attributed the narrowing of the field to a reduction in the amount of money available for the project. As Mr. Luhlier explained to the Subcommittee staff, the SBA was told that there would not be enough funds to go around for multiple firms, so it was necessary to change the East Coast, West Coast, Gulf Coast approach and focus on two firms. "We had to eliminate the West Goast and Gulf Coast. That left Medley and Wedtech." However, Mr. Luhlier's assertion that the Navy changed its position on the amount of funding available in the initial years of the pontoon project appears to be unsupported. A Navy procurement forecast provided to the SBA in January 1984—less than three weeks prior to the official selection of Wedtech and Medley—reflected a planned purchase of $31.5 million of powered and non-powered causeway sections in FY 84.[35] This forecast was *up* from an August

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[31] In March 1987 the Subcommittee staff reviewed all files relating to Wedtech from the SBA's central offfice, regional office, and district office. In the course of this review, the staff was not able to locate a *single* internal SBA document relating to the selection of a candidate for the pontoon contract. Subsequently, the Subcommittee obtained a notebook containing materials utilized by Joe Bennett in the selection process. This notebook contains photographs, detailed financial reports, and firm resumes of Wedtech, Medley, A.M.A. Enterprises, and Martinez Custom Trailers. Some correspondence from Lee Engineering is also included, as are financial print-outs on several other companies. Even the Bennett notebook, however, contains no material assessing or evaluating any of these firms. There is no memorandum explaining why Wedtech was selected for the contract, of why other companies were eliminated. Indeed, there is not even any explanation why detailed information is included only on Wedtech, Medley, AMA and Martinez and not on other companies.

[32] Hearing Record, Part 1 at 152.

[33] Hearing Record, Part 1 at 149, 151.

[34] Hearing Record, Part 2 at 23 (Testimony of Capt. de Vicq).

[35] December 12, 1983 "Planned Procurements" Chart.

1983 projection that only $24.7 million of pontoon causeways would be required in FY 84.[36]

Mr. Bennett and Mr. Rogers offered yet a third explanation for the selection of Wedtech and Medley: the Navy insisted that the field be limited to one prime contractor and one subcontrator, and that both be located on the east coast. As a result, the West Coast, Gulf Coast, and Great Lakes firms had to be dropped. According to Mr. Rogers, two Texas firms remained in the running on the basis of location, but were ruled out for other reasons—possibly because they would have required substantial SBA assistance to perform.

In fact, the Navy does not appear to have insisted upon a single East Coast contractor for the pontoons. On the issue of single versus multiple contractors, Mr. Sanders testified that "Secretary Pyatt agreed at the outset that we would have four firms performing this contract on the different coasts." [37] Mr. Pyatt himself told the Subcommittee staff that he was not particularly concerned how many contractors the SBA selected, as long as they were capable of performing—"It was not a big deal. You just have to look at who is doing what and what capabilities they have."

As to the location of the manufacturer, Mr. Pyatt acknowledged that there was some "worry about shipping costs," but this was "not a big issue." Mr. Pyatt's January 6, 1984 letter agreeing to set aside the pontoon contract notes that "the delivery point(s) will be East Coast locations"—but does *not* specify that an East Coast *manufacturer* is required. As Mr. Luhlier explained to the Subcommittee staff, the Navy just told the SBA that delivery was to be on the East Coast; it was the SBA that concluded that the manufacturer could not ship the pontoons from anywhere else. Navy procurement officials interviewed by the Subcommittee staff have confirmed that the Navy made no demands with regard to the geographic location of the SBA contractor.

Furthermore, the "East Coast" requirement cannot explain the elimination to Lee Engineering, which had contracted for facilities in Puerto Rico to handle such a requirement. Asked why Lee Engineering was rejected, Mr. Bennett expressed his view that Lee was "not really an East Coast company." He added that he was not sure it was economically feasible to manage a Puerto Rican operation from the West Coast, and that costs in Puerto Rico probably would have been higher than in New York. However, this explanation fails to explain why the SBA encouraged Lee Engineering to pursue the contract—and the Puerto Rican joint venture—in the first place.

b. The Problems with Wedtech.—In any case, there were several obvious problems with the selection of Wedtech to build the pontoons.

First, at the time Wedtech was nominated for the pontoon contract, the company had already received the Army engine contract—one of largest manufacturing contracts ever awarded by the SBA. Mr. Sanders told the Subcommittee staff that he believed that with this contract the SBA had already satisfied its obligation—and the Administration's promise—to help the South Bronx:

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[36] Attachment to August 15, 1983 letter from Mr. Pyatt to Senator Hecht.
[37] Hearing Record, Part 1 at 149.

"I felt we had kind of done that thing as far as South Bronx employment with the Army contract." Mr. Sanders stated that the objective with the pontoon contract was not to help the South Bronx, but to bring in a large contract and "spread it around." Mr. Sanders also acknowledged that he was concerned with the possibility that the SBA might be putting too many eggs in one basket with Wedtech.[38]

At the time the pontoon contract was awarded, Wedtech was already having problems performing the Army engine contract. An internal SBA memorandum from early 1983 indicates that Wedtech was overwhelmed by the task of absorbing this new work:

> The firm, due to the 8(a) assistance, has experienced a tremendous and rapid growth in orders/contracts. . . . [I]t is my opinion[] that that the total saturation point has been reached or exceeded. . . . Any attempt to increase the output through adding machinery without improving the overall production process could result in total 'choke' or exponential increase in production costs for all items produced in the plant.[39]

Marvin Liebman, the Administrative Contracting Officer responsible for administering the engine contract (and an employee of the Defense Contract Administrative Service (DCAS)), told the Subcommittee staff that Wedtech overcame its initial problems, but never came close to meeting the contract schedule. In early 1985, Wedtech had already failed its "first article" test on the engine contract and was several months delinquent in its deliveries.

Second, the purpose of the 8(a) program is to enable disadvantaged firms to become competitive. For this reason, the SBA's Standard Operating Procedures make failure to develop non-8(a) business a basis for program termination or graduation.[40] By late 1983 and early 1984, Wedtech was not meeting its non-8(a) business goals; indeed, it was relying on the 8(a) program for 95% of its business.[41] The award of the pontoon contract would obviously exacerbate this situation, making Wedtech even more heavily dependent on the program.

Wedtech's excessive reliance on 8(a) contracts concerned some SBA officials. In an interview with the Subcommittee staff, Mr. Rogers stated his belief that Wedtech should have been weaned away from its 8(a) reliance and should not have been awarded additional large 8(a) contracts after its program term extension in January 1984. With regard to the pontoon contract, Mr. Rogers stated that it was "not a good idea" to award the entire contract to Wedtech because of the possibility that the financial burden might "ruin the firm."

In his testimony before the Subcommittee, Mr. Rogers denied stating that Wedtech should not have been awarded more contracts, but stated that, as a general rule, companies that are already heavily dependent on 8(a) support should not be given additional large contracts:

> Mr. ROGERS. . . . If you have a firm that is overly dependent on 8(a) contracts, you find that condition, what you normally do at this time is to withhold new re-

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[38] *See* Hearing Record, Part 1 at 152.
[39] February 7, 1983 memorandum from Mr. Vaitas to Mr. Saldivar.
[40] SBA Standard Operating Procedures, Paragraphs 105(1); 108.1(b).
[41] January 5, 1984 memorandum from Mr. Rose to Mr. Neglia; Tr. 107 (Testimony of Mr. Rogers).

quirements until they can demonstrate that they have built up the non-8(a) work such that you have an adequate balance. Because after all, the goal of the program is not to give contracts but more to graduate a firm that can stand on both of its legs after it has graduated from the 8(a) program.[42]

In short, at a time when the SBA should have been taking steps to wean Wedtech away from its 8(a) dependence, the SBA instead selected Wedtech as the SBA's candidate for the pontoon contract—the largest 8(a) contract in the history of the program.

Third, Wedtech was not even eligible for the 8(a) program at the time the selection process was under way. As discussed above, Wedtech's 8(a) term expired in October 1983; the company itself acknowledged that it was no longer owned and controlled by disadvantaged individuals as a result of its public stock offering; and the company's owners appear to have overcome any possible "economic disadvantage" with the success of this stock sale. These eligibility issues were finally resolved in Wedtech's favor—on the basis of the sham stock transaction described above—at the same time that Wedtech was selected for the pontoon contract.

The SBA officials who selected Wedtech were aware of the problems with Wedtech's eligibility. Mr. Sanders testified before the Subcommittee that he was aware of Wedtech's public stock offering.[43] As Mr. Sanders told the Subcommittee staff, his decision to approve the participation of public companies in the program was made in the context of Wedtech's public offering, and not in the abstract: "We had to base everything on Wedtech." Mr. Saldivar, who attended a January 25, 1984 meeting with Mr. Sanders at which Wedtech was presented to the Navy as the SBA's candidate for the pontoon contract, signed a letter extending Wedtech's 8(a) term that same day.[44]

Mr. Neglia, the New York Regional Administrator who is reported by Mr. Sanders and Mr. Lunlier to have pressed them to consider Wedtech for the pontoon contract, also signed a letter approving the sham stock transaction. In fact, David Elbaum, the former SBA District Counsel in New York, testified that Mr. Neglia directed him to reach "a 'fast' decision" on the validity of the transaction "because there was a conference of some kind in Washington with regard to a contract that was to be awarded to Wedtech."[45] Mr. Rogers, a deputy to Mr. Neglia who participated in the selection of Wedtech, testified that he was aware of both the public stock offering and the so-called stock "sale" at the time they took place.[46]

Finally, Wedtech did not even have an SBA designation as a shipbuilder at the time it was selected to perform the pontoon contract. SBA officials who played a role in Wedtech's selection have told the Subcommittee staff that they viewed a change in Wedtech's industrial classification as a mere formality. The SBA's regulations have subsequently been amended to prohibit such changes, except in narrowly defined circumstances.[47] As explained below,

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[42] Hearing Record, Part 1 at 57; *see id.* at 54.
[43] Hearing Record, Part 1 at 128–29.
[44] January 25, 1984 letter from Mr. Saldivar to Mr. Mariotta.
[45] Hearing Record, Part 1 at 110, 111.
[46] Hearing Record, Part 1 at 45–47.
[47] C.F.R. Section 127.207 (1986).

Wedtech had absolutely no experience with the type of metal-working and assembly tasks required by the contract.

c. The Elimination of Medley.—On January 30, 1984, Mr. Sanders wrote to Mr. Pyatt, officially designating Wedtech and Medley as the SBA's contractors for the pontoon program. On February 2 and 3, Navy personnel conducted site visits to review the facilities of both Wedtech and Medley. On February 8, representatives of the two companies met with top SBA officials in Washington to discuss the contract. At the conclusion of this meeting, a handwritten agreement dividing up the contract between Wedtech and Medley was initialled by the two companies. A formal memorandum of understanding was prepared in draft, and negotiations between the companies continued.

On February 26, 1984, the Navy received a letter from Wedtech announcing that Medley had been dropped as a subcontractor. The Wedtech letter stated that Wedtech had reached this decision, without informing the SBA, because Medley's prices were out of line.[48] In a June 10, 1987 interview with the Subcommittee staff, Mr. Rogers confirmed that Medley's prices were higher than Wedtech's. However, Mr. Rogers stated that the SBA's initial response to this situation was to work with Medley to lower the company's proposed prices. Ultimately, Medley was dropped not because of its prices, but because SBA officials learned that the company was under investigation by the agency's Inspector General.

This was confirmed by Mr. Wilfong and by Mr. Luhlier—who in February 1984 had taken a new post as the SBA's Regional Administrator in Philadelphia. As Mr. Wilfong explained.

> Mr. Wilfong. I understand that Medley . . . got knocked out of the box . . . on some IG—Inspector General investigation relative to some irregularities which had been cleared up some while ago. But they resurfaced, and so consequently what happened is Medley was under investigation and could not be a part of that selection process. And so consequently, Wedtech remained as the sole contractor.[49]

Mr. Luhlier told the Subcommittee staff that he received a telephone call from Mr. Sanders and his new Chief of Staff, Bob Santy, who told him that Medley would have to be dropped because of the investigation.

According to Mr. Moreno, Wedtech's consultants quickly learned of the Medley investigation:

> In January and February 1984, we [Wedtech] met with representatives of Medley to negotiate the terms under which the two companies would share the contract. During these negotiations, I received a call from Mark Bragg, who told me that Medley would be unable to participate in the contract because of some kind of investigation into their conduct. I do not know, and I did not inquire[,] how Mr. Bragg obtained this information. Shortly after this phone call, however, Medley was dropped from the contract.[50]

No SBA official has been able to explain to the Subcommittee how Mr. Bragg—or any Wedtech representative—could have had access to confidential information about an ongoing investigation of an 8(a) company.

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[48] February 26, 1984 letter from Mr. McCarthy to Mr. Schroder.
[49] Hearing Record, Part 2 at 51.
[50] Affidavit of Mr. Moreno, Paragraph 12.

3. THE NEGOTIATION OF THE CONTRACT

a. The Site Visit.—On January 6, 1984, Mr. Pyatt wrote to Mr. Sanders, agreeing to consider the SBA's nominee for the pontoon contract. As explained above, Mr. Pyatt testified that this letter did not commit the Navy to set aside the pontoon contract for performance by an 8(a) company. Mr. Pyatt emphasized that a final decision to set the contract aside was made only after the SBA nominated Wedtech and the Navy assessed the company's ability to perform.[51] Mr. Pyatt testified that the key step in this evaluation process was a site visit to Wedtech by NAVFAC personnel: "the decision really got made when we got this trip report back from the people who went up to the facility."[52]

The NAVFAC personnel who reviewed Wedtech's facilities in February 1984 found that the only facility that Wedtech had for the performance of the pontoon contract was an empty building without power or electricity. Wedtech's lack of existing production facilities was clearly indicated in the report of this site visit. After praising the facilities that Wedtech had dedicated to the performance of other contracts, the report went on to describe Wedtech's proposed facilities for the pontoon contract:

> a. Contractor provided transportation to his 149th Street facilities listed on his brochure as 215,000 sq. ft. This facility was recently acquired and is just a shell of a building. Roof is not finished, no facilities inside, such as heat, light or sanitary fixtures. Electrical service for the building will be provided by 3 diesel generators to produce approximately .5 m.w. Building is not designed for overhead crane service, and painting of pontoons is planned to be accomplished under a bubble outside. . . .
>
> b. A walk-through tour was requested as to how contractor was to move pontoons to waterfront area to assemble causeway sections. Contractor proceeded to lead party over railroad track, along a road owned by a trucking company, then onto a private junk area to look at 35,000 sq. ft. of waterfront property owned by Wedtech. Contractor's plan is to negotiate right of way and install a concrete pad upon which causeways will be assembled. Unit then will be moved into water by floating crane.[53]

A second memorandum to Mr. Pyatt, dated March 15, 1984, provided a similar description of Wedtech's facilities.

Captain David de Vicq, the Navy program manager who conducted the site visit, testified before the Subcommittee that he found the state of Wedtech's facilities "frightening." He explained:

> Captain DE VICQ. Well, to meet the schedule, an awful lot had to happen to that structure, rapidly. It was not impossible for that to happen. I have been involved in construction throughout my adult life, and I know that if you get a good contractor and you turn to, that indeed they could set that place straight. So it was not imposible, certainly not demonstrably impossible, but it was sure starting a long climb at the very bottom of the hill.[54]

The bottom line of NAVFAC's report on the site visit was that Wedtech could do the job, "given sufficient time to include completion of facilities to be used, obtaining right of way(s), hiring new help, especially qualified welders, and contracting out for data support," but could not meet the Navy's schedule.[55] Captain de Vicq

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[51] Hearing Record, Part 2 at 139, 151–52.
[52] Hearing Record, Part 2 at 145, 143.
[53] February 6, 1984 Trip Report at 3.
[54] Hearing Record, Part 2 at 15.
[55] February 6, 1984 Trip Report at 3, 4.

testified that he "did not so much conclud[e] they could [perform the contract] as conclud[e] that you could not prove they could not." [56] This statement was supported by Commander John Sullivan, who also participated in the site visit. In an interview with the Subcommittee staff, Mr. Sullivan explained that, although there was no certainty that Wedtech could produce pontoons, "The handwriting was already on the wall" that Wedtech would get the contract. The feeling at NAVFAC, Mr. Sullivan stated, was that "This was going to be 8(a) negotiated. The best we could do would be to eliminate those candidates we thought were totally out to lunch."

Defense Department officials responsible for monitoring Wedtech's performance on ongoing contracts concurred in NAVFAC's judgments. Marvin Liebman, Wedtech's Administrative Contracting Officer, told the Subcommittee staff that "everyone in their right mind knew it was impossible" for Wedtech to meet the Navy's schedule, because there was only from April to October for the company to get set up and build the first pontoons. Mel Zitter, Mr. Liebman's contract administrator, made the same point: "Given the time and the money, it was basically the kind of thing anybody could do"—the problem was that the Navy did not have as much time as Wedtech needed.

b. The Assistant Secretary's Approval.—Mr. Pyatt testified that he approved Wedtech for the pontoon contract because the trip report concluded that Wedtech had the technical capability to build pontoons and the only question mark was Wedtech's ability to meet the Navy's schedule.[57] Mr. Pyatt explained that he was not worried about Wedtech's ability to meet the contract schedule, because he believed that other elements of the Sealift Program were slipping in any case.[58] In response to post-hearing questions from the Subcommittee, Mr. Pyatt was unable to produce any documentation to support his claim that other elements of the program were slipping.[59] In fact, a January 19, 1984 point paper for a Navy meeting attended by Mr. Pyatt specifically stated that "MPS 1 Ships being built or converted are being delivered on/or ahead of schedule." While Admiral Hughes testified that he was greatly concerned that Wedtech would not be able to meet the Navy's critical time schedule,[60] Mr. Pyatt testified that schedule slippage was not a major issue.[61]

At the time of the set-aside and award to Wedtech, however, Mr. Pyatt manifested a deep concern about the importance of timely delivery. Two letters from Mr. Pyatt to Mr. Sanders in January and February 1984 make this point. The first letter, on January 25, stated:

> I have reviewed the procurement manager's detailed analysis of production schedules and have concluded that only the most vigorous and innovative action to identify a contractor, achieve a contract, and to produce both the Integrated Logistics

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[56] Hearing Record, Part 2 at 15.
[57] Hearing Record, Part 2 at 143–46.
[58] Hearing Record, Part 2 at 143, 145.
[59] November 16, 1987 letter from Mr. Pyatt to the Subcommittee.
[60] Hearing Record, Part 2 at 86.
[61] Hearing Record, Part 2 at 153.

System Documentation and the physical hardware can meet Navy test and delivery requirements.

The second letter, dated February 9, stated:

The operational needs of the Navy for these systems are critical. Had the program gone forward as a competitive procurement, the Command had planned less than 30 days for industry to review and bid.

At a January 19, 1984 meeting with Navy procurement personnel, Mr. Pyatt stated the urgency of the procurement more bluntly, saying that "if the 8(a) contractor did not have the production facilities now, prior to award, he could not play in the ballgame as it would be impossible to meet scheduled delivery dates." [62]

In his testimony and in interviews with the Subcommittee staff, Mr. Pyatt gave differing explanations of his position with regard to Wedtech's facilities.

First, in an interview with the Subcommittee staff, Mr. Pyatt stated that he had insisted that the pontoon contractor have existing production facilities in place and was concerned that Wedtech might not have such facilities in place—"That was why we sent folks up to look." Mr. Pyatt asserted that Wedtech had all of the essentials—a building, cutting machines, welding equipment, and a skilled labor force—already in place. According to Mr. Pyatt, "My impression was that Wedtech had this, the basic things needed. The issue was how quickly they could get a production process on line and operating."

Second, in his testimony before the Subcommittee, Mr. Pyatt denied that existing facilities were a factor in his consideration of a contractor for the pontoon contract:

Senator COHEN. Did you place any particular requirements on the type of facilities that the contractor had to have in order to qualify for a set-aside?

Mr. PYATT. No. We only asked the program manager to go up and review and give his opinion.[63]

Mr. Pyatt went on to state that Wedtech had "rudimentary" facilities in place and that he believed that these facilities would be adequate to build the pontoons.[64]

Third, under questioning from the Subcommittee, Mr. Pyatt acknowledged that he had, in fact, told NAVFAC officials that an 8(a) contractor without facilities in place prior to award "could not play in the ball game." [65] Mr. Pyatt acknowledged that Wedtech did not have facilities in place, but asserted that such facilities "were in the process" and "could come together in time." [66] Mr. Pyatt stated that he had changed his mind in accepting Wedtech despite the company's lack of existing facilities.[67]

c. *The Lack of a Pre-Award Survey.*—Despite concerns expressed by the site review team about Wedtech's ability to perform the pontoon contract in a timely manner, a full pre-award survey of Wedtech was never conducted.[68] A pre-award survey would have

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[62] "Synopsis of 19 January Meeting".
[63] Hearing Record, Part 2 at 141.
[64] Hearing Record, Part 2 at 141.
[65] Hearing Record, Part 2 at 146.
[66] Hearing Record, Part 2 at 147.
[67] Hearing Record, Part 2 at 147.
[68] A limited pre-award survey of Wedtech was conducted prior to the award of the pontoon contract. However, the Navy deleted requirements to review technical, production, transporta-

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provided the Navy an opportunity to check on the quality and timeliness of Wedtech's work on other contracts, to carefully survey Wedtech's facilities and capabilities, and to check on Wedtech's financial condition. As it was, Commander John Sullivan of NAVFAC told the Subcommittee staff, the Navy learned that Wedtech was delinquent on the Army engine contract, but Wedtech raised "a lot of flack" about whether the Army was at fault and NAVFAC had no time to get to the bottom of the dispute. According to Commander Sullivan, the Navy heard that Wedtech had gone public and "generated all kinds of revenue," but had no time to do a thorough financial study and determine whether sufficient financing was available

NAVFAC's one-day site visit provided the Navy with some basic information on Wedtech, but did not meet Navy standards for a pre-award survey. According to a point paper prepared for Mr. Pyatt's January 19, 1984 meeting with NAVFAC, a site survey of less than fourteen days would pose a considerable risk on this procurement:

> Site surveys are comfortably accomplished and reported in from 30 to 45 days, depending on the product being procured. Twenty-one days have been allowed for the normal case, 18 for Risk Level 1 (moderate risk) and 14 for Risk Level 2 (significant risk). Site surveys are important to 8a procurements.

Marvin Liebman, the Administrative Contracting Officer responsible for the pontoon contract, told the Subcommittee staff that the Navy's refusal to conduct a pre-award survey prior to awarding such a major contract to an unproven manufacturer was "very unusual". In Mr. Liebman's words, this omission was "unheard of for an award of this size on a contract that the company had never done before." Mr. Liebman added that the one-day site survey conducted by the Navy in early February was "not a substitute" for a meaningful pre-award survey.

It appears that no pre-award survey was conducted because of the pressure on NAVFAC to complete negotiations with Wedtech as soon as possible. A January 5, 1984 memorandum of a meeting between Mr. Pyatt and uniformed Navy personnel concludes that an 8(a) award can be expedited, but that "pressure from OPNAV [the Office of Naval Operations] and ASN [Mr. Pyatt's office]" will be required to compress the schedule.[69] In his testimony before the Subcommittee, Captain de Vicq explained that the Navy did not require a pre-award survey because such a survey would have taken too much time, given the time-urgent nature of the contract.[70] In an interview with the Subcommittee staff, Commander Sullivan explained that: "We had a delivery schedule that had to be met. Ships that had to sail."

d. The Price Negotiations.—Wedtech and the Navy were initially far apart on price. On February 26, 1984, Wedtech submitted a cost

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tion, labor resource, and ability to meet required schedule. The review of plant facilities and equipment, financial, and purchasing and subcontracting systems was conducted on a strictly limited basis. Only quality and performance elements of the survey were conducted as originally planned. April 10, 1984 Negotiation Memorandum at 29. Mr. Pyatt was inconsistent in his testimony as to whether he was aware that no pre-award survey had been conducted. *Compare* Hearing Record, Part 2 at 140 *with id.* at 154.

[69] January 5, 1984 memorandum of Commander Troy re: "FY87 Powered Causeway Procurement".

[70] Hearing Record, Part 2 at 16.

proposal in the amount of $35.9 million, while the Navy set the Fair Market Price (FMP) at $24.2 million.[71] Over the next three weeks, Wedtech reduced its price first to $33.2 million and then to $30.5 million.[72] However, this proposal was premised on a $550,000 Business Development Expense (BDE) Grant that had not been considered or approved by the SBA.[73] The Navy refused to reconsider its Fair Market Price and an impasse was reached.

On March 15, 1984, NAVFAC's Deputy Commander for Facilities Acquisition, Captain R.A. Lowery, sent a memorandum to Mr. Pyatt in which he explained that negotiation deadlines set by the Assistant Secretary had passed and no agreement was in sight:

> We are now beyond the 9 March date in our timeplan when a decision to proceed to audit of the proposal and final negotiations or to terminate consideration must be made. We believe that the exchange of proposal and FMP, and associated dialog to date, constitute an adequate good faith effort during which it has become apparent that negotiations alone cannot bridge the difference between Navy and the proposer's cost estimates. Absent an entirely new and less costly technical approach or a significant allocation of Business Development assistance from SBA, prompt termination of the Section 8(a) consideration seems necessary to preserve any opportunity to meet delivery dates required to support the MPS.

Captain Lowery recommended that Mr. Pyatt contact Mr. Sanders about the possibility of a substantial BDE grant to Wedtech and, in the absence of such an SBA commitment, terminate negotiations by close of business on March 16.

Rather than cut off negotiations, Mr. Pyatt directed that his Small Business officer, Richard Ramirez, call a meeting with the SBA and Wedtech to attempt to resolve their differences. According to a Navy memorandum of this meeting, the SBA informed the Navy that it would not make up the price differential with BDE funds:

> [Mr. Saldivar] stated that Wedtech had previously received substantial assistance from SBA on other work, had recently become a public corporation and had, thereby, gained significant funding. He noted that additional SBA financial support was a somewhat controversial issue within SBA. Later, at the conclusion of the meeting, Mr. Saldivar stated that SBA would not consider funding assistance to Wedtech until negotiations between the procuring activity and Wedtech had concluded.[74]

Wedtech continued to dispute the validity of the Navy's price, and the price differential between Wedtech and the Navy remained unchanged at the close of the meeting. Rather than terminate negotiations, however, Mr. Ramirez requested that Wedtech submit a new proposal and directed that the Navy "proceed to audit."[75]

On March 19, 1984, Wedtech submitted a revised cost proposal in the amount of $29.6 million.[76] Although this proposal differed only marginally from Wedtech's previous proposal, the Navy neither raised its Fair Market Price nor attempted to withdraw the procurement and go competitive. The parties stood fast until March 28, 1984, when Wedtech and the SBA finally agreed to accept the Navy's price. In exchange, the Navy agreed to include the full

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[71] April 10, 1984 Negotiation Memorandum at 10-11.
[72] April 10, 1984 Negotiation Memorandum at 13, 14.
[73] March 15, 1984 memorandum from Capt. Lowery to Mr. Pyatt.
[74] March 19, 1984 memorandum from Capt. de Vicq to "Distribution".
[75] March 19, 1983 memorandum from Capt. de Vicq to "Distribution".
[76] April 10, 1984 Negotiation memorandum at 28.

option quantities for 1985 and 1986 in Wedtech's contract, with price negotiations to take place at a future date.[77]

The Wedtech pontoon contract presents a classic case of a contractor "buying in" to the front end of a program. The final contract price was $4 million lower than the price that Wedtech and the SBA had insisted was necessary for the company to break even. Wedtech officials frankly admit that they accepted a big loss on the contract in the belief that they could make up the difference on the options. As Mr. Wallach put it in a March 3, 1984 file memorandum:

> Through the process of extensive negotiation, they have achieved the reinsertion of options for the future. However, the price of $24.3 million is fixed and they will lose approximately $4 million on it. The question now is whether they will receive business development funds from the SBA which will allow them to convert that into a profit rather than a loss. They will make up their loss, presumably, on awarding of the future options to them for additional construction over the next five years.

Former Wedtech Executive Vice President Mario Moreno has told the Subcommittee staff that there was a second important factor in Wedtech's decision to accept the contract on a loss basis: Wedtech was preparing for a $40 million offering of stock debentures and needed the pontoon contract in order to persuade investors to put up the money.

SBA officials, having participated in the negotiations throughout, were aware that Wedtech would probably lose money on the basic contract. New York Deputy Administrator Aubrey Rogers told the Subcommittee staff that "we were convinced that they needed more money to do the job." Mr. Rogers stated that Wedtech was "not averse to investing and losing money on the initial contract"—they "just wanted the options." This was confirmed by other SBA officials. SBA Deputy Associate Administrator Robert Saldivar, for example, testified that "Wedtech expressed their view that they could recover some of the potential losses under the first part of the contract in future options." [78] Similarly, the SBA's contract negotiator for the pontoon contract, Augustus Romain, told the Subcommittee staff that he felt Wedtech could make up on the options whatever it lost on the initial contract.

Mr. Rogers and Mr. Romain acknowledged that the SBA does not ordinarily approved loss contracts, but maintained that the pontoon contract was different because of Wedtech's belief that it could make up the money on the options. The SBA's Standard Operating Procedures state that "SBA will not accept requirements that may cause an 'adverse impact' upon a small business concern." [79] Such an adverse impact is considered to exist whenever "[t]he procurement is of such magnitude or complexity as to be incapable of performance by 8(a) concerns or is otherwise inappropriate for performance by 8(a) concerns." [80] In his testimony before the Subcommittee, Mr. Saldivar denied that this regulation precludes the SBA from entering loss contracts.[81] Mr. Saldivar did

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[77] March 28, 1984 letter from Mr. Wilfong to Mr. Pyatt.
[78] Hearing Record, Part 2 at 56.
[79] SBA Standard Operating Procedures, Paragraph 53(a).
[80] SBA Standard Operating Procedures, Paragraph 63(a).
[81] Hearing Record, Part 2 at 56.

concede, however, that it "was not a very prudent judgment for the SBA" to allow Wedtech to buy in.[82]

The SBA's decision to include an option to purchase the Navy's 1985 and 1986 pontoon requirements in Wedtech's contract also ran counter to the agency's announced strategy and rationale for pursuing the contract in the first place. As explained above, SBA Administrator James Sanders stated that he never intended for the pontoon contract to go to a single company. Even when Wedtech was named the SBA's candidate for the first year of the contract, SBA officials continued to maintain that later installments of the contract would go to other companies. Yet Wedtech ended up getting the entire procurement.

SBA officials stated that this was not the intended result. Mr. Rogers, for example, told the Subcommittee staff that if the SBA "had been approached by the Navy and told that they wanted Wedtech for the pontoons," there would have been substantial opposition. Mr. Rogers explained that "that was not the way this thing started"—it started with the idea of involving a number of contractors from around the country. "So the idea of Wedtech as one of many would not make us jump. Nobody saw Wedtech getting $20 million or even $10 million." As a result, Mr. Rogers stated, "the reality of what this would do to the 8(a) side did not hit us until we were well into negotiations." Mr. Sanders' former Chief of Staff, Robert Luhlier, was more blunt in his interview, stating, "I guess that in retrospect, we had a good plan. If we had stuck to the plan it could have worked. But we allowed ourselves to get handled."

4. DISCUSSION AND FINDINGS

a. The SBA's Selection Process.—Wedtech never formally requested that the SBA consider it as a candidate for the pontoon contract. Numerous other 8(a) companies did request consideration, however, and several of these companies went to great lengths to qualify for the contract and to establish facilities to build the pontoons. At least two companies—Univox and Lee Engineering—were led to believe that they had a strong chance of receiving a significant part of the contract. Nonetheless, when the contract was finally awarded in April 1984, Wedtech was the sole recipient and the other interested companies were never told why they had been rejected.

SBA officials told the Subcommittee that Wedtech was chosen for the pontoon contract through a rational selection process. These officials stated that they requested detailed information on the financial status, facilities and capabilities of potential candidates from the SBA's regional offices and systematically evaluated this information to select the strongest and most capable contractors from the entire portfolio of 8(a) firms.

This explanation is unconvincing for several reasons.

First, there are absolutely no documents in SBA files explaining why Wedtech was selected or how it was determined to be more capable than other contractors.

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[82] Hearing Record, Part 2 at 57.

Second, the various SBA officials who participated in the selection process provided inconsistent explanations for the award to Wedtech:

(1) SBA Administrator James Sanders testified that Wedtech was selected because it was the only candidate capable of performing. This statement was contradicted by other SBA officials who stated that several candidates could have built the pontoons.

(2) Mr. Sanders' former Chief of Staff, Robert Luhlier, told the Subcommittee staff that Wedtech was selected because of a cut in the funding available for the project made it impossible to use four different firms, as originally planned. Navy documents obtained by the Subcommittee show that the projected budget for the project actually increased in the four months before the SBA selected its candidate.

(3) Two special assistants in the 8(a) office—Mr. Rogers and Mr. Bennett—told the Subcommittee that Wedtech was selected because the Navy insisted on a single contractor located on the East Coast. However, Navy officials deny that they made these demands.

Third, there were numerous obvious reasons why Wedtech should not have received the contract. For example:

(1) Wedtech had already received the Army engine contract, and SBA officials were generally reluctant to have one 8(a) contractor responsible for two of the agency's largest and most important contracts.

(2) Wedtech had a great deal of difficulty performing the engine contract, so the pontoon contract would mean adding another line of business before the company had fully absorbed the first.

(3) Wedtech was already dependent on the 8(a) program for 95% of its business in late 1983, and the pontoon contract would make the company even more dependent on the program.

(4) Wedtech was not even eligible for the 8(a) program during the period—after the company's public stock offering and before the SBA's approval of the sham stock sale—when the selection process took place.

(5) Wedtech had no facilities with which to build pontoons and had no experience with similar assembly contracts.

No SBA official has provided a convincing explanation as to why these obvious problems with the selection of Wedtech were overlooked. As Senator Cohen stated in his concluding remarks at the Subcommittee hearing, the incredible series of coincidences that led to the award of the entire contract to Wedtech creates at least the appearance that the firm was favored because of its connections:

> [In] this particular case, even though there was a socially desirable goal of putting up jobs in the New York area . . . there were some things that were done along the way that should have been raising smoke signals to various individuals, saying that as much as you want to put jobs up there . . . there are some things that are wrong along the way. And the appearance, if not the reality, of the situation is that it was a purely political judgment that was made to give it to this particular firm because of connections—because of the lobbying that was done . . . even though there [were] a lot of danger signals being emitted.[83]

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[83] Hearing Record, Part 2 at 162.

Finally, there is evidence that direct pressure was brought to bear on the SBA by Wedtech and its well-connected consultants. For example:

(1) Navy notes on a January 1984 telephone call quote an unnamed SBA official as stating that "the biggest political guns ever seen" would support the SBA's choice of contractors.

(2) The minutes of a meeting between SBA and Wedtech officials in February 1984 quote SBA Chief of Staff Robert Luhlier as stating that "[a] lot of political blood has been shed" over the contract.

(3) Mr. Luhlier told the Subcommittee staff that Wedtech was "chomping at our heels" for the contract.

(4) SBA Assistant District Director Hank Diaz told the Subcommittee staff that when he asked a regional official about the pontoon contract, he was told to "hush up because it was coming from the top".

(5) Former Wedtech Executive Vice President Mario Moreno told the Subcommittee staff that he and various Wedtech consultants contacted SBA officials, including former Administrator Jim Sanders, former Deputy Associate Administrator Robert Saldivar, and former New York Regional Administrator Peter Neglia on numerous occasions to seek assistance for the company's efforts to get the pontoon contract.

The Subcommittee finds that the SBA ignored obvious problems with Wedtech's 8(a) eligibility, overdependence on 8(a) contracts, and ability to perform when it selected Wedtech as its candidate for the pontoon contract. The evidence received by the Subcommittee creates at a minimum the appearance that Wedtech was chosen because it was well-connected and not because of its qualifications or because it was the best candidate. The Subcommittee further finds that the inconsistent explanations given by SBA officials for the selection of Wedtech are implausible and insufficient to explain why the obvious problems with Wedtech were overlooked.

b. The Conduct of the Deputy Associate Administrator.—Former SBA Deputy Associate Administrator Robert Saldivar admitted to the Subcommittee that he was offered a gift of $12,000 by a Wedtech consultant at some time in 1983 or 1984, while he was an SBA official. Mr. Saldivar stated that the gift was offered on behalf of Wedtech officials, in "gratitude" for his "accomplishments." Mr. Saldivar did not report this offer, which he acknowledged to have been "irregular", to the SBA Inspector General or to anyone else.

Indeed, Mr. Saldivar continued to play a role in SBA and Navy decisions regarding Wedtech for some two years after the incident:

(1) SBA officials have told the Subcommittee that Mr. Saldivar met with Navy officials about the pontoon contract on several occasions in late 1983 and early 1984.

(2) In his testimony before the Subcommittee, Mr. Saldivar acknowledged that he "may have" told other SBA officials that he believed Wedtech to be the best qualified candidate for the contract.

(3) On January 25, 1984, Mr. Saldivar signed the letter granting Wedtech a three-year extension of its 8(a) term.

(4) On the same day, he attended a meeting at which Wedtech was presented to the Navy as the SBA's candidate for the pontoon contract.

(5) In February 1984, Mr. Saldivar was assigned to the SBA team responsible for negotiating the pontoon contract.

(6) In October 1984, Mr. Saldivar took a new post at the Navy, in which he was responsible for monitoring Wedtech's performance for the Assistant Secretary's office.

(7) In 1985 and 1986, Mr. Saldivar made several trips to Wedtech, met with Wedtech officials, and reported to the Assistant Secretary's office on Wedtech's performance.

Moreover, Mr. Saldivar appears to have obtained Wedtech's assistance in making career moves. Two file memorandum written by Mr. Wallach in February and March 1984 stated that certain assignments for Mr. Saldivar would help Wedtech. On February 21, Mr. Wallach stated that Mr. Saldivar should be assigned to handle the pontoon project; three days later, he was. In March, Mr. Wallach suggested that Mr. Saldivar should be promoted to Associate Administrator; five months later, he was officially delegated the powers of that post. In October 1984, Wedtech sent Mr. Wallach a copy of Mr. Saldivar's resume and two weeks later Mr. Saldivar was given a job by the Navy. In his testimony before the Subcommittee, Mr. Saldivar admitted that he might have discussed possible career moves with Wedtech officials or consultants. The appearance that Wedtech was able to influence personnel decisions of the SBA and the Navy is deeply disturbing.

Mr. Saldivar's failure to report Wedtech's offer was a clear violation of SBA regulations, which require employees to report such irregularities to the agency's Inspector General.[84] At the very least, Mr. Saldivar had powerful reason to believe that Wedtech officials and consultants may have been engaging in illegal acts in their efforts to gain federal contracts. As such, he was in a unique position to blow the whistle on Wedtech and prevent the company from continuing its illegal and improper activities (which have already led to eleven convictions or guilty pleas and ten additional indictments in federal court) for another two and a half years. Instead, Mr. Saldivar continued to do business as usual with the company, to meet with the company's principals, and even to discuss career moves with them.

The Subcommittee finds that Mr. Saldivar's conduct in failing to report Wedtech's attempted payment to him and continuing to participate in federal decisions relative to Wedtech was a clear violation of SBA regulations and was highly improper.

c. The Navy's Approval of Wedtech.—The pontoon causeway program was an significant component of the strategically important Rapid Deployment Force. Navy officials were aware that timely delivery of the pontoons was important to the United States' ability to respond to crisis situations around the world. As Mr. Pyatt stated at a January 19, 1984 meeting with NAVFAC officials, a contractor would have to have facilities in place at the time of the contract award in order to meet the Navy's schedule. Nonetheless, Navy officials overlooked Wedtech's obvious inexperience and lack of facilities in their haste to award the contract.

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[84] 13 C.F.R. Section 105.516(a). There is a possibility that Mr. Saldivar's conduct was even worse: it is a crime to offer anything of value to a federal official for or because of an official act, 18 U.S.C. Section 201, and a crime to conceal knowledge that a felony has been committed. 18 U.S.C. Section 4.

Navy officials who conducted a one-day review of Wedtech's facilities in February 1984 found that the company had only an empty shell of a building in place for the performance on the contract. The Wedtech facility had no roof, no electricity, no heat, no light, no sanitary fixtures and no machinery for building pontoons. Wedtech planned to build the pontoons with certified welders (who had not yet been hired), paint the pontoons in a bubble (which had not yet been built), move them across a railroad track (which Wedtech did not yet own) to a concrete pad (which had not yet been built) and launch them with a floating crane (which Wedtech had not yet acquired). The Navy Program Manager testified that it was "not demonstrably impossible" for Wedtech to perform the contract, but that "it was sure starting a long climb at the very bottom of the hill."

As Senator Cohen explained:

> I think the basic mistake was made that this company should not have been in the business of performing this type of work. I think the Admiral [Hughes] reflected the proper sentiment, that when you need something of this importance and urgency, you do not farm it out on an 8(a) basis to a firm that does not have the background and experience; and it was done for political reasons rather than military justification, and we are paying the price for it right now.[85]

Assistant Secretary Everett Pyatt had earlier stated that an 8(a) contractor without existing facilities "could not play in the ballgame as it would be impossible to meet scheduled delivery dates." However, Mr. Pyatt changed his mind and approved the selection of Wedtech on the basis of the one-day site visit. Mr. Pyatt testified that he was not concerned about schedule slippage because other elements of the Sealift Program were slipping in any case. In fact, contemporaneous Navy documents indicate that (a) Mr. Pyatt was highly concerned about the delivery schedule; and (b) other elements of the program were expected to be delivered on or ahead of schedule. *For these reasons, the Subcommittee finds that the Navy approved the award of the pontoon contract to Wedtech despite the knowledge that the company could not meet the Navy's critical production schedule, because it lacked relevant experience and existing production facilities.*

A full-scale pre-award survey of Wedtech would have uncovered even more problems by providing the Navy an opportunity to review Wedtech's (delinquent) performance on other contracts and ascertain the company's (weak) financial condition. Department of Defense officials have told the Subcommittee staff that the award of such a major contract to an unproven manufacturer without such a preaward survey is "unheard of". However, no pre-award survey was conducted, apparently because contract negotiation deadlines were fast approaching and award of the contract to Wedtech was considered a foregone conclusion in any case.

In light of the urgency and importance of the pontoon contract and Wedtech's inexperience and the questions raised by the Navy's one-day site visit, a pre-award survey should have been conducted. *Accordingly, the Subcommittee finds that the Navy improperly rushed to a procurement decision without a pre-award survey necessary to fully evaluate Wedtech's capabilities.*

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[85] Hearing Record, Part 2 at 124; *see id.* at 123.

E. Wedtech's Performance and the Options

1. The Piersall Report

a. The Decision to Seek a Report.—Wedtech ran into performance problems from the moment the pontoon contract was awarded in April 1984. Wedtech had to build a facility and put together a work force from scratch, an "almost impossible task" [1] given the Navy's stringent schedule, which called for delivery of the first units within six months, in October 1984. The pontoon building had no roof and no electricity at the time Wedtech started production. Wedtech responded to this problem by installing temporary generators around the building—in violation of EPA regulations, since the fumes from the generators blew into the roofless building. An inspection of Wedtech's plant by the Defense Contract Administration Service (DCAS) in August 1984 uncovered a host of problems and led to a recommendation that DCAS employees should be removed from the plant for their own safety until these problems could be corrected.[2]

At the same time, Wedtech had trouble hiring qualified welders and getting approval for deviations they wanted to make from the contract specifications. These difficulties were exacerbated by Wedtech's weak management structure, which was not prepared to handle the doubling and redoubling of the company's business within such a short period. As the Navy's contracting officer explained to the Subcommittee, Wedtech's corporate performance was "inefficient," "unskilled" and "short on accomplishments and follow-through". The company's production planning and progress reporting were "woefully inadequate." And its quality control systems were "poorly managed," "inadequately documented," and failed to produce solid corrective action.[3]

DCAS and the Navy responded by bringing in extra personnel to establish a quality control plan and production reporting system for Wedtech and to provide the company with general technical and engineering assistance.[4] Nonetheless, the company's production and quality control problems persisted.

On August 2, 1984, Everett Pyatt was confirmed by the Senate as Assistant Secretary of the Navy for Shipbuilding and Logistics; on August 6, he appointed Wayne Arny as his Principal Deputy and assigned him to handle 8(a) matters, including the Wedtech pontoon contract.[5] Three weeks later, on August 27, 1984, Mr. Arny

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[1] In an interview with the Subcommittee staff, New York Deputy Regional SBA Administrator Aubrey Rogers stated that the Navy put Wedtech "through an almost impossible task. The contractor had to start from scratch, get a work force of certified welders, get a plant to meet Navy requirements, get materials in place, get established."

[2] August 29, 1984 memorandum from Mr. Pierce to Mr. Liebman.

[3] Hearing Record, Part 2 at 17–18 (Testimony of Capt. de Vicq).

[4] Hearing Record, Part 2 at 19 (Testimony of Capt. de Vicq); *id.* at 27 (Testimony of Col. Hein).

[5] Mr. Arny's handwritten notes from the period indicate that he was quickly made aware of the problems of Wedtech.

attended a meeting between Navy and SBA officials about two large 8(a) contracts, including the pontoon contract. In his testimony before the Subcommittee, Mr. Arny stated that SBA and Navy officials disagreed on several significant points about the pontoon contract, including "the delivery of Government-furnished equipment, Wedtech's projected production capability, the performance of the contractor and the performance of the Government." [6]

Mr. Arny testified that he responded by calling for an independent assessment of the project:

> Mr. ARNY. . . . I was concerned with the extent of the conflicting allegations as with the disagreement between SBA and NAVFAC personnel over who was responsible for the difficulties. I was new in my position and unfamiliar with 8(a) contract oversight. . . . Consequently, on September 10, 1984, I requested . . . a thorough, independent assessment of the entire powered causeway program.[7]

Mr. Arny designated Captain Charles Piersall of the Naval Sea Systems Command (NAVSEA) to perform this review. Mr. Arny testified that when he served on the staff of the Senate Armed Services Committee he had worked with Captain Piersall and that Piersall had experience with amphibious and sealift programs.[8]

Mr. Arny testified that he did not consider his decision to call upon Captain Piersall for an independent report on Wedtech's performance to be unusual or out of the ordinary.[9] The Navy Program Manager, Captain David de Vicq, testified that he viewed this decision as extremely unusual, however.[10] In an interview with the Subcommittee staff, Captain Piersall stated that he had never seen any other such independent review of a program in his tenure with the Navy. Mr. Arny, in response to post-hearing questions from the Subcommittee, described several occasions on which he requested independent assessments on issues of controversy, but was unable to provide an example of another case in which he requested an independent review of a particular contractor's performance outside the normal chain of command.[11]

b. The Report.—Captain de Vicq testified that Captain Piersall talked to him only "[v]ery briefly" as part of his investigation. Mario Moreno of Wedtech, on the other hand, told the Subcommittee staff that he found Captain Piersall "very friendly to us." Mr. Moreno reported that he had a private conversation with Captain Piersall on Wedtech's boat launching pier, in the course of which Piersall said that he was there to help. According to Mr. Moreno, "Piersall told me that things were going to improve drastically. He [said that he] had been called in to troubleshoot."

On September 17, 1984, Captain Piersall delivered an interim report, in which he noted that Wedtech and the Navy disagreed as to responsibility for inspection requirements and the performance of Government-furnished equipment. If these disagreements were resolved, Captain Piersall concluded, Wedtech should "be able to complete powered causeways to a schedule slightly behind the con-

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[6] Hearing Record, Part 2 at 101.
[7] Hearing Record, Part 2 at 101; *see* November 13, 1987 letter from Mr. Arny to the Subcommittee.
[8] Hearing Record, Part 2 at 101.
[9] Hearing Record, Part 2 at 128, 129.
[10] Hearing Record, Part 2 at 20.
[11] November 13, 1987 letter from Mr. Arny to the Subcommittee.

tract schedule, but one that will support the Maritime Prepositioning Ships." The interim report did not mention Wedtech's test failures, continuing schedule slippage, material handling problems, or production line disarray.

In a final report to Mr. Arny two weeks later, on September 28, Captain Piersall identified eighteen "issues," only two of which involved Wedtech's performance: (a) "Wedtech is prone to deliver data to SBA rather than to the ACO [Administrative Contracting Officer]"; and (b) "A number of incomplete [change control] packages have been submitted by Wedtech." The report concluded with six recommendations, only one of which was addressed to Wedtech: "Wedtech should insure that complete technical data is submitted with each ECP [Engineering Change Proposal]." In short, the only shortcomings Captain Piersall found in Wedtech's performance involved the company's data submissions. The substantial problems with Wedtech's production methods, quality and timeliness that had been observed by other Navy personnel were not mentioned.

In a cover memorandum transmitting the final report to Mr. Pyatt, Mr. Arny reported Captain Piersall's bottom line: "Wedtech can produce the causeways (inc. options) on time." [12] In his testimony before the Subcommittee, Mr. Arny stated that he "felt that although Wedtech was not performing the contract on time, the delays which had ensured were not solely attributable to Wedtech." [13] Captain Piersall similarly emphasized in an interview with the Subcommittee staff that his report was just a quick and dirty look at the situation. In retrospect, Captain Piersall acknowledged Wedtech's problems and stated that the Navy "had 'heartburn' with delivery." [14] The report itself does not acknowledge Wedtech's responsibility for any problems, however. As Mr. Arny testified before the Subcommittee, "all the indications that I had received were that Wedtech would be able to perform and build quality causeways." [15]

c. The Wedtech Letter.—On October 9, 1984, Mr. Arny received an advance copy of a Wedtech letter to NAVFAC, in which Wedtech requested an extension of delivery dates for the pontoon causeways and attributed the delay to problems with Government-furnished equipment. Mr. Arny sent this letter—which had not yet been sent to NAVFAC by Wedtech —to Captain Piersall. In a cover memorandum, Mr. Arny asked for Captain Piersall's advice as to whether Wedtech should send the letter:

> Please take a look at the attached letter. It has been signed, but not released.
>
> I am leaving for Norfolk with the tide, so to speak, but I will be back this evening. I would like your comments as soon as you can give them to me. Should the letter be sent; are the pumps this much of a problem; can we afford to approve their later schedule?

On October 12, Captain Piersall responded by advising Mr. Arny that (a) Wedtech could not meet the Navy's schedule; (b) the Wedtech letter might be a "smoke screen" for Wedtech's problems, but

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[12] October 2, 1984 memorandum from Mr. Arny to Mr. Pyatt (handwritten).

[13] Hearing Record, Part 2 at 102.

[14] Captain Piersall also noted that he did not review Wedtech's finances, as he thought that a request to review the company's books at that time would have been regarded as a "hostile act."

[15] Hearing Record, Part 2 at 102.

(c) nonetheless recommended that the letter be sent to "surface the problems":

> The schedule proposed by WEDTECH will not support the [Navy's schedule] . . . .
> The validity of WEDTECH's concerns as to the impact on production of dimensional discrepancies cannot be determined without visual assessment. DCASMA or NAVFAC should assess immediately.
> I am concerned that WEDTECH appears to be taking an attitude of "My hands are tied and I'm waiting for you to provide the technical solution to the dimensional problem." The WEDTECH allegation that the Government has experience in installing this pump may not be valid. . . .
> DCASMA and NAVFAC will feel this letter is another "smoke screen" for WEDTECH's problems. It may be to an extent, but if there is any validity to the extent of the problems he portrays he will have an excusable delay. I recommend WEDTECH send this letter. This will surface the problems and lead to resolution.

Mr. Arny testified that Wedtech's Washington representative, Mark Bragg, requested that he review the letter before it was sent.[16] Mr. Arny acknowledged that he had passed Captain Piersall's recommendation on to Mr. Bragg.[17]

Mr. Arny testified that he did not believe it was unusual or improper for him to advise Mr. Bragg on whether to send a letter to NAVFAC:

> Mr. Arny. . . . It was not unusual for a Washington representative to say we are concerned about something, we are going to send a letter, but if that is going to upset the system, we do not want to do that. . . . I did not feel at this time that this was an unusual request. If we are going to send a letter, is there going to be a problem with that? And it was my impression that the Washington rep wanted to maintain as good [a] relationship as possible with the Navy system.[18]

In response to post-hearing questions from the Subcommittee, however, Mr. Arny was unable to provide any other example of an occasion on which he had provided such advice to a contractor.[19]

In a May 15, 1987 interview with the Subcommittee staff, Captain Piersall denied that he had any further involvement with Wedtech or the pontoon contract after he delivered his report to Mr. Arny. Asked in a later interview about his exchange of memoranda with Mr. Arny, Captain Piersall could not explain why Wedtech's letter would have been sent to him in advance and denied that he had approved the letter in any way.

d. The Response to the Report.—On October 3, 1984, Mr. Arny forwarded the Piersall Report to NAVFAC, DCAS and others. In a covering memorandum, Mr. Arny requested that each organization "give me comments on each recommendation that applies, as well as any plans that may be necessary to implement these recommendations."

On October 26, R.W. Kesteloot, the Director of the Logistics Plans Division in the Office of Naval Operations responded by noting that Captain Piersall's recommendations were applicable to NAVFAC and not to his office. Captain Kesteloot then reported that the Navy continued to have problems with Wedtech's performance as well as its prices, and recommended that the FY 85 options on the contract be removed from the 8(a) program and competitively bid:

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[16] Hearing Record, Part 2 at 115.
[17] Hearing Record, Part 2 at 116.
[18] Hearing Record, Part 2 at 115.
[19] November 13, 1987 letter from Mr. Arny to the Subcommittee.

Aside from the performance problems which we are experiencing with the contractor there is the issue of no competition. Without it our costs are significantly higher. The results of the negotiations of the FY-85 procurement contract will confirm this statement. I believe we would be better served if we could get the procurement of the causeway systems removed from the article 8A restriction.

On October 30, Colonel Don Hein of the DCAS responded to Mr. Arny's memorandum by stating that Captain Piersall's recommendations had been implemented insofar as they applied to DCAS. He then went on to state that Wedtech continued to suffer from substantial delays and quality problems. At about the same time, Mr. Arny received word that Wedtech would not meet the optimistic schedule laid out in Captain Piersall's report. Mr. Arny noted in a handwritten memorandum that these new delays were due to "some problem w/ pumps—but also some with contractor."

On November 15, 1984, Captain de Vicq responded to Mr. Arny's memorandum. Captain de Vicq stated that Captain Piersall's recommendations had been implemented, although this was made more difficult by Wedtech's "difficulty in developing stable, clear and meaningful schedules." Captain de Vicq went on to volunteer his own comments on Captain Piersall's report:

(1) Government representatives had expended extraordinary efforts to assist Wedtech—helping not only by developing production control systems, but also by providing key parts out of Navy stock.

(2) Because this level of effort "was neither envisioned nor budgeted," additional funds would be necessary to cover contract management expenses.

(3) Contrary to Captain Piersall's conclusions, the Government-furnished pumps "have not been the pacing factor" for Wedtech's delays since the first pump was installed.

(4) The optimistic delivery schedules provided to Captain Piersall by Wedtech "did not occur", as the first two units (which should have been completed the previous week) were only slightly more than half-built.

(5) Wedtech's delays "will result in our inability to provide powered causeways when required for initial loading of any of the first three MPS ships."

Captain de Vicq stated that the Navy was "pleased with the observable quality of Wedtech fabrication work," but concluded that while he was "optimistic about quality," he remained "deeply concerned by current and potential delivery schedule slippages." As Captain de Vicq explained to the Subcommittee, he believed that the Piersall report was superficial and overly optimistic:

Captain de Vicq . . . . The finding that I agreed with least was the notion that Wedtech was soon to be producing right along and that our estimates of their production were too pessimistic. I frankly did not know how they could arrive at that conclusion in the extremely brief amount of time they were given.[20]

2. THE 1985 OPTIONS

a. Wedtech's Efforts to Influence the Navy.—Under the terms of the pontoon contract, the government had the option to purchase additional quantities from Wedtech in fiscal years 1985 and 1986. The Navy committed itself to negotiate with Wedtech over the

[20] Hearing Record, Part 2 at 20.

prices for these options for ninety days; if no agreement was reached, the option quantities would be withdrawn from the contract.[21] Wedtech and the Navy started negotiations in the summer of 1984, but negotiations quickly broke down because Wedtech wanted almost twice as much money as the Navy believed was appropriate.

Upon the expiration of the 90-day period provided by the contract, the Navy informed the SBA that negotiations would continue until October 15, 1984, when they would be terminated if no agreement had been reached. The Navy letter explained that the October 15 cut-off date was necessary to ensure that the Navy would be able to "meet the required MPS [Maritime Prepositioned Ships] sailing dates should the negotiations be unsuccessful." [22]

At the same time, the numerous production and schedule difficulties encountered by Wedtech throughout the summer and fall of 1984, raised substantial concerns within the Navy as to whether the options should be awarded to Wedtech at all. Former Deputy Chief of Naval Operations Admiral Thomas J. Hughes, Captain de Vicq, and Colonel Hein all testified before the Subcommittee that they strongly opposed the exercise of the options in the fall of 1984.[23]

In the fall and winter of 1984, Wedtech learned of this opposition in the uniformed Navy, and turned to its consultants for assistance.[24] A November 12, 1984 memorandum from Mr. Wallach to Wedtech officers and directors shows that the company considered using its political "ally structure" to influence Captain de Vicq. This memorandum suggested that Wedtech's contracts in the Government should be used to favor officials who assisted Wedtech:

> As we discussed, a private meeting with Captain D. should be arranged at the Company as soon as possible . . . . Generally speaking [you should make an] implicit suggestion that if he wants his record to look good, obtain a promotion, etc., that by working with you and your working with him, that is the most efficient way to achieve everyone's common goal.
>
> He should be aware of Wedtech's general ally structure. He doesn't have to know it in detail. The fact that we have it, and his awareness of it, ought to be gently indicated so that he understands that we will view favorably with all we know, his efforts to legitimately conclude this agreement and fulfill the Navy's responsibilities to the public.

Captain de Vicq has told the Subcommittee that no such meeting ever took place.[25] Mr. Moreno confirmed this, telling the Subcommittee staff that Wedtech had instead made efforts to "get de Vicq out" and to go over his head. Captain de Vicq testified that at least two former high Navy officials, Mr. Arny and Mr. Saldivar, suggested to him that he was "riding Wedtech too hard." [26] Mr. Arny confirmed that he believed that de Vicq was riding the company too hard, although he did not specifically remember saying so.[27] Mr. Saldivar denied making such a statement.[28]

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[21] Navy contract 28410183, pp. 13-14, Note 4.
[22] July 18, 1984 letter from Mr. Buonaccorsi to Mr. Rose.
[23] Hearing Record, Part 2 at 93-94, 22, 39, 28-29.
[24] Affidavit of Mr. Moreno, Paragraph 13.
[25] Hearing Record, Part 2 at 20-21.
[26] Hearing Record, Part 2 at 19.
[27] Hearing Record, Part 2 at 19.
[28] Hearing Record, Part 2 at 71.

At about the same time, Mr. Moreno has told the Subcommittee in a sworn affidavit, he and Wedtech President John Mariotta met with Mark Bragg to discuss the pontoon contract options. As Mr. Moreno described the meeting, Mr. Bragg insisted upon substantial payment for his efforts to get the options for Wedtech. According to Mr. Moreno, an agreement was reached under which Mr. Bragg would be paid $200,000 if Wedtech got the options—and twice that if Wedtech got the options with a price to be determined later (which would have put Wedtech in the driver's seat with regard to price):

> Mr. Bragg said that it would be very difficult for Wedtech to get the options. He further stated that he wanted compensation for his efforts to help Wedtech. After negotiation between him and Mr. Mariotta and me, we agreed that he would get $400,000 from Wedtech if the options were awarded without price negotiations and $200,000 if they were awarded after price negotiations.[29]

Subsequently, Mr. Moreno stated, Wedtech agreed to pay an additional $150,000 to Mr. Wallach if Wedtech succeeded in obtaining the options.

b. The Letter Contract Issue.—On November 18, 1984, Mr. Arny received a memorandum from the office of Naval Operations stating that "there are problems at Wedtech," and the company would not meet the Navy's schedule for launching its MPS ships.[30] The very next day, Mr. Arny signed a memorandum to NAVFAC in which he directed the exercise of the FY 85 pontoon contract options. In his testimony before the Subcommittee, Mr. Arny stated that before he could follow the NAVFAC recommendation to drop Wedtech, he believed that he needed "some solid technical reasons to do so, other than slippages." [31] In an interview with the Subcommittee staff, Mr. Arny stated that he did not believe that Wedtech's schedule slippage was a subject of great concern, because "it wasn't wartime."

Mr. Arny's memorandum to NAVFAC called for the award of the options to Wedtech by "letter contract" (*i.e.*, with price to be determined later) by December 3, 1984:

> I request that you proceed to exercise the Fiscal Year 1985 contract options on the subject program to the current contractor, Wedtech Corporation . . . .
>
> I recommend that the contract vehicle be similar to a start work order with a substantial obligation of funds, a minimum of 50% of the estimated cost. Further, a projected not too [sic] exceed dollar figure that is considered fair and reasonable shall also be included.
>
> I desire that the above action be completed by 3 December 1984.

The terms of this order would have authorized Wedtech to start spending money on the FY 85 options prior to price negotiations. Captain de Vicq explained in his testimony before the Subcommittee that this kind of arrangement would have amounted to "a license to steal," because the government would have been required to pay Wedtech whatever Wedtech spent, plus a profit:

> Captain DE VICQ. [A letter contract] directs a contractor to proceed, costs to be established at a later date. That is basically what a letter contract does. They are

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[29] Affidavit of Mr. Moreno, Paragraph 14.

[30] October 16, 1984 memorandum from Cdr. Worthington. The memorandum bears the handwritten notation—"To: Mr. Arny"; this notation is circled, and a second notation states "Came over telecopier 11/18 0930."

[31] Hearing Record, Part 2 at 112.

used extraordinarily rarely. But I can tell you the kind of situation under which you would use one.

Let us say you are commanding officer of a Naval station, and a typhoon hit it, and it wiped out a number of facilities, among them your radio facility, and you felt you had to have that immediately. You could then give a letter contract to a fellow to come in and get that up for you right now. The idea is that you negotiate and go to a formal contract as rapidly as possible thereafter.

And in my view, had we tried that with Wedtech, that would have been a license to steal, because they could have dragged their feet on negotiation for a substantial amount of time; they could have made it impossible to negotiate by withholding information that had to be audited, and that would have dragged it out; and in essence, the Government is bound to pay what the costs are to a contractor before such a negotiation could be completed.

So to me it was—and I will say it again—a license to steal.[32]

Other Navy officials questioned by the Subcommittee agreed that a letter contract would have had the effect of giving Wedtech the money it wanted without negotiations. Admiral Richard Miller stated that he objected strongly to this "unprecedented business arrangement." Admiral John Paul Jones stated that he opposed a letter contract because such a contract would have encouraged Wedtech to delay negotiations as long as possible because the longer it delayed the more the contract would be like a "cost-plus" contract.[33] The award of the options without price negotiations would have been particularly significant because Wedtech was seeking $68 million for the options at the time, while they Navy thought the fair market price for the options was only $42 million.

Moreover, by directing an award to Wedtech by December 3, 1984, Mr. Arny's memorandum would have deprived the Navy of an important opportunity to assess Wedtech's performance prior to the award. Wedtech's "first article" test, which was originally scheduled to begin on October 29, was postponed by Wedtech delays until a month after Mr. Arny sent out his November 19 memorandum. First article tests are used to protect the government by requiring that the contractor prove that it can produce an acceptable unit—a "first article." The Federal Acquisition Regulation states that, prior to first article testing, the risks of production should be placed on the contractor and even the purchase of materials—let alone the exercise of options—should only be authorized by the government where absolutely necessary.[34] In this case, it was particularly important not to exercise the options prior to the first article test because of the possibility that that test would prove Wedtech's inability to perform—as in fact it did.

Mr. Arny testified that he did not know what a "letter contract" was at the time he signed the November 19 memorandum.[35] Mr. Arny stated that he assumed that the price of the options would be subject to negotiations between the Navy and Wedtech even after he signed this memorandum.[36] He explained that he did not pre-

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[32] Hearing Record, Part 2 at 23.

[33] *See also* Hearing Record, Part 2 at 94-95 (Testimony of Admiral Hughes). Mr. Arny acknowledged that letter contracts are "not normal" and are "frowned upon by the Navy." *id.* at 114.

[34] 48 C.F.R. Section 9.305.

[35] Hearing Record, Part 2 at 112. The November 19 memorandum does not actually use the term "letter contract"—it calls ir[illegible] for "a start work order with a substantial obligation of funds, a minimum of 50% of the e[illegible]ated cost."

[36] Hearing Record, Part 2 at 125.

pare the memorandum himself and although he read the memorandum before he signed it, the language of the memorandum did not mean much to him,[37] as he did not inquire what a letter contract was.[38] Mr. Arny testified that Mark Bragg urged him to exercise the options [39] and strongly denied that Mr. Bragg or anyone else had suggested that they should be exercised without price negotiations.[40] Admiral Hughes testified that he understood that the idea for a letter contract had started with Mr. Arny himself:

> Senator LEVIN. Now, when you say you objected to a letter contract being issued as proposed—by whom—by Mr. Arny.
> Admiral HUGHES. Mr. Arny made a visit up there, and subsequent to that time proposed that we issue the contract in the interest of keeping them going. I think they had a cash flow problem on the business side, and I think that that was probably the impetus.[41]

Mr. Arny was unable to explain the source of the November 19 memorandum. Mr. Arny testified that he probably asked somebody in his office to prepare a letter directing the exercise of the option and that this was the memorandum that came back. However, Mr. Arny did not know who in his office prepared this particular memorandum. In fact, he testified that a retired secretary with whom he inquired stated that "she thought it came from outside the Shipbuilding and Logistics staff"—in other words, from outside Mr. Arny's staff.[42] The Subcommittee staff interviewed more than twenty Navy officials in an effort to identify the source of the November 19 memorandum; not one could recall having seen the memorandum before it was issued.

c. The Exercise of the Options.—On November 21, 1984, Admiral John Paul Jones, Jr., the Commander of NAVFAC, replied to Mr. Arny's directive and "respectfully requested" that Mr. Arny reconsider the letter contract issue. Admiral Jones explained that Wedtech and the government were still $26 million apart on price and a letter contract would make negotiations more difficult and "foreclose any realistic Government option to seek other means of production." Five days later, Admiral Jones' superior, Admiral Richard Miller, called Assistant Secretary Pyatt directly to complain about the directive. Confronted with these arguments, Mr. Arny directed that NAVFAC instead proceed with expedited negotiations.[43]

Wedtech's first pontoon was delivered to the Navy one month later, in late December. The pontoon failed its "first article test"—with 88 Wedtech deficiencies documented in a single unit. Wedtech's first units were not even square, meaning that they could not be removed and replaced and would not be repairable if damaged in the field.[44] As Captain de Vicq explained, these failures were due to Wedtech's "inattention," "lack of skill" and "inexperience" in using the sophisticated machinery required for the

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[37] Hearing Record, Part 2 at 125.
[38] Hearing Record, Part 2 at 112, 113.
[39] Hearing Record, Part 2 at 105.
[40] Hearing Record, Part 2 at 124-25.
[41] Hearing Record, Part 2 at 94.
[42] Hearing Record, Part 2 at 113, 122.
[43] Hearing Record, Part 2 at 112-13; December 11, 1984 memorandum from Admiral Miller to Mr. Pyatt.
[44] Hearing Record, Part 2 at 18 (Testimony of Capt. de Vicq).

84-801 O - 88 - 6

project.[45] Colonel Don Hein, the chief of the Defense Contract Administration Service Management Area in which Wedtech was located, testified that Wedtech went so far as to use sledge hammers in an attempt to make defective pontoons fit into their assemblies, a technique that was hardly likely to produce the kind of quality the Navy required.[46]

By the time the first article test had been completed, the Navy's October 15, 1984 deadline to bring in a second source for the FY 85 options was already months past. As Captain de Vicq explained in a February 12, 1985 memorandum, there just wasn't enough time left to bring in a second source and get the pontoons in time to meet the Navy's delivery schedules:

> The real windows to drop the 85 option were missed last fall, as we said at [a meeting with the Assistant Secretary] last September. We take the position that to resolicit now we must do it right . . . We must give the market 45 to 60 days to bid and we must do a good pre-award survey. That being the case we would be 6 to 8 months worse off resoliciting . . . than exercising 85 Option.[47]

Admiral Hughes reluctantly concurred in this conclusion, even while noting that he had little, if any confidence, in Wedtech's ability to meet even new, extended schedules:

> In our deliberations we determined that not giving the FY-85 option to WEDTECH would probably result in a further five-month delay. I have no doubt that WEDTECH will offer us many proposals that would seemingly meet our schedule. Their past performance, however, has not supported their optimistic projections.[48]

As Admiral Hughes explained in this testimony before the Subcommittee, the Navy did not have far to fall in terms of time or cost, but "the promises they had every time were always golden, and hope springs eternal to try and save money."[49]

After lengthy negotiations over price, the FY 85 pontoon options were awarded to Wedtech on March 15, 1985, at a price of $51.5 million—some $16 million less than the Navy would likely have had to pay if the options had been exercised prior to price negotiations. At that time, Wedtech still had not delivered a single acceptable pontoon under the basic contract, and the first such delivery was not yet in sight.[50]

3. THE 1986 OPTIONS

a. The Hughes Memoranda.—The Navy's decision to award the FY 85 options to Wedtech did not consitute a vote of confidence in the company. In Spring and Summer of 1985, Admiral Hughes sent a series of memoranda to Mr. Pyatt and Mr. Arny, urging them to take the 1986 options away from Wedtech. In his first memorandum, on February 20, 1985, Admiral Hughes noted that prospects for timely delivery by Wedtech were "dismal at best."

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[45] Hearing Record, Part 2 at 18.

[46] Hearing Record, Part 2 at 26.

[47] *See* Hearing Record, Part 2 at 22, 39 (Testimony of Captain de Vicq).

[48] February 20, 1985 memorandum from Admiral Hughes to Mr. Pyatt. *See* Hearing Record, Part 2 at 93 (Testimony of Admiral Hughes).

[49] Hearing Record, Part 2 at 97.

[50] Captain de Vicq and Colonel Hein testified that the pontoon contract was put on emergency report status at the Pentagon as a result of Wedtech's failures. As Captain de Vicq explained, this "red status" means that "You are behind; there is probably more trouble in the future, and you had best solve it fast." In December 1984 and January 1985, Wedtech was forced to stop assembly of its current work in an attempt to identify the causes and the required corrective action for these massive problems. Hearing Record, Part 2 at 19.

This puts the Navy in the uncomfortable position of having a large investment in equipment at sea to respond to crises which cannot offload in the stream in the required five days. After careful review of WEDTECH's progress to date, the problems they are still experiencing and the prognosis for recovery, I now consider it imperative that we take what action we can to limit the exposure to their inability to perform.

In the interest of limiting risk he recommended that the Navy remove the causeway contract from the 8(a) program and go instead to open competition. This recommendation had been transmitted orally to Mr. Arny a week earlier.

In April 1985, Mr. Arny made a personal trip to Wedtech to assess the situation. He returned to Washington convinced that Wedtech could build the pontoons. As Mr. Arny explained to the Subcommittee, Wedtech had hired a new production manager, who gave him confidence in the company. [51] Mr. Arny also concluded that the Navy had "misplaced oversight of the Wedtech contract with NAVFAC."[52] A handwritten note from the Assistant Secretary's office, dated April 8, 1985, reflects Mr. Arny's decision to recommend "monitoring Wedtech progress for a period of about six weeks prior to decision on 86 option." [53]

In May 1985, Admiral Hughes tried again to convince Mr. Pyatt and Mr. Arny to drop Wedtech. In a May 8 memorandum, Admiral Hughes advised the Assistant Secretary's office that Wedtech's performance had deteriorated to the point where "[w]e are past the point of simple schedule slippages and are now dealing with a very real degradation of our sealift offload capability." Admiral Hughes explained that delays in pontoon deliveries had already forced the Navy to "make several decisions that effectively reduced overall readiness," thereby "reducing the Navy's amphibious assault capability." The Admiral forcefully stated that these delays were attributable to inadequacies in Wedtech's production techniques:

With the exception of minor delays experienced in delivery of the initial GFE [Government-furnished equipment] propulsion pumps and correction of a debris contamination problem in the GFE pumps, responsibility for delay in lighterage delivery rests with the contractor. WEDTECH's problems include a multitude of items such as: (1) inadequate production and assembly facilities, (2) improper tooling procedures, (3) absence of necessary production and assembly work procedures, (4) inadequate quality control measures and, (5) inexperience in building small craft/ships.

Admiral Hughes concluded by stating that he did "not see satisfactory progress" by Wedtech in remedying these problems and by reiterating his "strong recommendation that we act now to cut our losses" by going competitive with future pontoon requirements.

Mr. Arny responded to the second Hughes memorandum by directing a new review of the pontoon contract by Navy officials from outside NAVFAC.[54] In June 1985, the Navy Supervisor of Shipbuilding, Conversion and Repair (SUPSHIPS) reviewed Wedtech's performance and found that the company's current production planning was "inadequate;" that there were "problems with meeting tolerances in fabricated units, necessitating extensive rework;" and that Wedtech had failed to supply cost performance data as required by the contract. Nonetheless, the report concluded that

[51] Hearing Record, Part 2 at 111-12.
[52] Hearing Record, Part 2 at 103.
[53] April 8, 1985 memorandum from Cdr. Heuelet to Mr. Saldivar.
[54] Hearing Record, Part 2 at 103.

Wedtech could build the pontoons—Wedtech had "severe problems and difficulties with performance under the Contract, but they are currently in an ambitious 'Get Well' program, which has the potential of resulting in satisfactory completion of the Contract." [55]

Procurement officials responsible for monitoring Wedtech's performance on a day-to-day basis were not convinced by the optimism of this report. As Admiral Hughes and Colonel Hein explained to the Subcommittee, Wedtech always told Navy officials what they wanted to hear, but was always short on performance.[56] On August 26, 1985, Admiral Hughes sent another memorandum to Mr. Pyatt complaining that Wedtech had again proven incapable of meeting even the schedules it set for itself. A handwritten memorandum from Mr. Saldivar to Mr. Arny on September 11 conveyed the same message: Wedtech would once again miss required delivery dates and another set of pre-positioned ships would have to sail without causeways. Mr. Saldivar added the note that Wedtech's proposed costs for the 1986 options were "out of line."

This time, Admiral Hughes did not recommend taking the pontoons away from Wedtech entirely. Instead, he sought a split procurement, under which a second 8(a) company would take over a portion of the contract from Wedtech. As Admiral Hughes concluded his August 26 memorandum: "The criticality of proceeding to establish a second production source is more than evident."

b. The Sole Source Decision.—The second source approach, unlike the open competitive approach, was accepted by Mr. Pyatt and his staff. After deliberating for a period of more than a month, Mr. Pyatt adopted Admiral Hughes' recommendation and directed NAVFAC to establish a second 8(a) source. As Mr. Pyatt explained in an October 11, 1985 memorandum to NAVFAC, this alternative was discussed with the SBA Administrator's office, which provided tentative approval.

In the winter of 1985–1986, the Navy lined up two 8(a) contractors on the West Coast with the potential to serve as a second source of pontoons. One of these companies dropped out, but the other—Bay City Marine—was interested.[57] Captain de Vicq testified that he and Mr. Saldivar went out to evaluate Bay City Marine's facilities. Captain de Vicq found Bay City Marine to be "far superior" to Wedtech in terms of its initial preparedness to build the pontoons.[58]

In early 1986, however, the Navy cut its budget for the sealift program—particularly for the pontoons. As an unsigned Navy memorandum noted on February 5, 1986, these budget cuts placed the wisdom of a split procurement in question:

> We are stretching out the buy to a point that I have to question whether it is smart to try to establish a second source.—Even after considering our growing pains with WEDTECH. There is enough for two sources in FY–86 . . . but FY–87 looks to be too small to support two sources without driving unit cost[s] out of sight.

On March 7, 1986, NAVFAC Vice Commander F.G. Kelley sent a memorandum informing the Chief of Naval Operations that the re-

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[55] June 13, 1985 memorandum from E.B. Fowler to Mr. Pyatt.
[56] Hearing Record, Part 2 at 90, 93, 99 (Testimony of Admiral Hughes); *id.* at 27 (Testimony of Col. Hein).
[57] Hearing Record, Part 2 at 78–79, 98 (Testimony of Admiral Hughes).
[58] Hearing Record, Part 2 at 23.

duced quantities of pontoons required in fiscal year 1986 rendered a second source less feasible. On March 24, Admiral Rowden, the Commander of the Naval Sea Systems Command, stated that he too, believed that the reduced quantities of causeways to be procured rendered a second source unnecessary. On March 31, 1986, Admiral Hughes accepted this recommendation, and Wedtech was left once again as the Navy's only source of pontoon causeways.

According to former Wedtech Executive Vice President Mario Moreno, Wedtech did not believe that it could economically produce pontoons in the quantities left by the Navy's budget cuts, even after the elimination of the second source. Accordingly, Wedtech decided to try to get the appropriation increased in Congress: "Creating the appropriation in Congress was the only way to go." Mr. Moreno stated that Wedtech sought assistance from Congressmen Biaggi and Addabbo and Senator D'Amato to push for the increased appropriation. In addition, the company hired Washington lobbyist John Campbell and Jim Aspin—the brother of Congressman Les Aspin—as consultants to assist in this effort.

Ultimately, the House-Senate conference report on the continuing resolution increased the pontoon appropriation by $48 million.[59] The Navy made no effort to return to the second-source concept, so Wedtech got what it wanted—an increased pontoon appropriation of which it would be the sole recipient.

c. The New Program Manager.—In January 1986, Captain de Vicqu was abruptly removed from his post as program manager and transferred to a less prestigious assignment. Captain David Schlesinger, who was responsible for finding a replacement for Captain de Vicq, has told the Subcommittee staff that the replacement process was unusual in its suddenness and urgency.

Mr. Pyatt testified that Captain de Vicq had become a problem on the pontoon contract because he was "an obstructionist and did not know what he was doing."[60] Mr. Arny also testified that Captain de Vicq, although he had a reputation for being tough and fair, was an obstructionist and had failed as a manager on the pontoon project.[61] Admiral Hughes acknowledged that there was friction between Captain de Vicq and Wedtech, but refused to place the blame with Captain de Vicq, pointing out that:

> Admiral HUGHES. . . . He was an intense, hard-working guy. He had a threshold that he could reach in frustration that he could be pretty hard to get along with. . . . I think he was very diligent, and he worked hard, but he just reached a point of being very frustrated in dealing with them—with Wedtech. . . . And they were not open; they would not talk and let us know what was going on so we could help them.[62]

NAVFAC officials who worked more closely with Captain de Vicq on a day-to-day basis state that he was an extremely capable program manager. Commander John Sullivan told the Subcommittee staff that he did not consider Captain de Vicq difficult to work with at all, and thought that "if anything he went out his way to help the contractor." Lieutenant Barbette Lowndes stated that Captain de Vicq was "right on top" of the project, "helping them

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[59] October 9, 1986 memorandum from Mr. Jenkins to Mr. Roemer.
[60] Hearing Record, Part 2 at 141.
[61] Hearing Record, Part 2 at 118–19.
[62] Hearing Record, Part 2 at 91.

[Wedtech] understand where their problems were." Captain de Vicq's personnel records described performance in dealing with Wedtech in glowing terms. Captain de Vicq's 1984–85 evaluation, for example, stated that he had "personally directed, guided, cajoled, and nurtured an SBA 8(a) contractor who is on a steep learning curve in producing sealift support facilities critical to the National Defense." His 1985–86 evaluation, similarly, stated that he had "made unique personal contributions to the [pontoon] program, literally rescuing the major procurement from apparent failure, and ensuring that critically needed sealift support equipment will be available to meet contingency needs."

Mr. Moreno told the Subcommittee staff that he had no first hand knowledge of any role Wedtech's consultants may have played in Captain de Vicq's removal. Mr. Moreno stated that there was a perception at Wedtech that Captain de Vicq "wanted to destroy the company;" company officials placed a high priority on having him replaced. Mr. Moreno believed that Wedtech's consultants were well aware of this goal: "I told everyone—Wallach, Bragg, and others—that we have to get rid of this guy." However, Mr. Moreno stated, none of these consultants ever told him that they had taken any specific action to have Captain de Vicq replaced.

Captain de Vicq was replaced by Captain Tim Kelley, who was brought in on an emergency basis to fill the job for just six months. Captain Kelley told the Subcommittee staff that he was a personal friend of Wedtech lobbyist and former deputy White House counselor Jim Jenkins, whom he knew through an organization of former Navy officials known as the "San Diego Society".[63] Captain Kelley reported that, by another coincidence, Wedtech consultant Jim Aspin was his brother's closest childhood friend. The Subcommittee has found no evidence that Wedtech played any role in the selection of Captain Kelley to replace Captain de Vicq.

In his six-month tenure, Captain Kelley took several actions that were helpful to Wedtech. In a March 28, 1986 memorandum, Captain Kelley recommended that the FY 86 options be awarded to Wedtech by letter contract "prior to receipt of audit findings and final negotiation." That same month, on a request from a White House aide to Mr. Arny, Captain Kelley provided a favorable evaluation of Wedtech's performance to the Army. As one of Mr. Arny's assistants explained in a handwritten note, "There is no report, but Tim [Kelley] was willing to talk to the Army, and to say that Wedtech is on track and doing well (or at least ok)."[64] A month later, when a pre-award survey of Wedtech recommended against an award of the FY 86 pontoon options to Wedtech, Captain Kelley demanded that a second survey be conducted.

In mid-summer, as Captain Kelley was about to leave the Navy, he assisted the company in obtaining a $75 million bond offering. John Pritchard, an attorney for Wedtech's underwriting firm—Bear, Stearns & Co., Inc.—has told the Subcommittee staff that the

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[63] On one occasion, Captain Kelley stated that Mr. Jenkins introduced him to his former boss, Attorney General Edwin Meese. Captain Kelley stated that he and Mr. Meese were amused by this introduction, as they were neighbors in suburban Virginia and already knew each other.

[64] March 11, 1986 handwritten note from Mr. Steadley to Mr. Arny.

firm asked Captain Kelley about Wedtech's performance on the pontoon contract prior to approving the offering. Acording to Mr. Pritchard, Captain Kelley conveyed "a bright, cheery message" to Bear Stearns, stating that early Wedtech problems had been "straightened out" and "Wedtech was on track." Captain Kelley and his successor as program manager, Captain Goodermote, confirmed in interviews with the Subcommittee staff that Captain Kelley told Bear Stearns that Wedtech problems were in the past and the company was now "cranking things out." [65]

In his testimony before the Subcommittee, Colonel Hein stated that DCAS informed Captain Kelley of problems with Wedtech's performance and finances during this period.[66] Colonel Hein further stated that information he disclosed to Captain Kelley in confidence somehow found its way into Wedtech's hands.[67] Captain Kelley explained to the Subcommittee staff that he simply did not believe the DCAs auditors when they told him of problems with Wedtech's performance and finances. Captain Kelley stated that DCAS officials had "no experience in this type of industrial procurement" and that Colonel Hein, in particular, had a "personal vendetta" against Wedtech. Captain Kelley concluded that DCAS' belief that Wedtech was incompetent and financially insolvent was "ridiculous" and failed to reflect the company's improvements in late 1985 and 1986.

d. The Two Pre-Award Surveys.—In fact, Mr. Moreno told the Subcommittee staff that Wedtech's financial condition was "precarious" throughout the entire period of the pontoon contract. As Mr. Moreno explained, Wedtech's finances were already strained when the company began its campaign for the contract. Wedtech nonetheless accepted the Navy's price on the initial contract, because it hoped to make up these losses and because it needed to show the contract as a receivable in order to complete a $40 million stock debenture offering the next month. According to Mr. Moreno, the company raised sufficient funds through this debenture offering to alleviate its financial difficulties for the rest of the year (1984).

Wedtech's inability to deliver acceptable pontoons to the Navy had a severe adverse financial impact on the company, however. Wedtech "saw no income and a lot of expenditures," Mr. Moreno stated—especially when the company was forced to shut down production and redesign its pontoon assembly line. By early 1985, Wedtech was again in financial trouble and had to raise additional money throgh new lines of credit with major banks. Wedtech's credit needs were aggravated when the company agreed to a price of $51.5 million—instead of the $68 million it wanted—for the 1985 pontoon options. At the end of 1985, Wedtech decided to undertake a new stock offering. According to Mr. Moreno, Wedtech officials believed that they needed a minimum of $30 million to remain solvent; the new stock offering, in January 1986, raised only $16 million.

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[65] Mr. Moreno reported that he last spoke to Captain Kelley in late 1986, when Captain Kelley called to request Mr. Moreno's assistance—through Mr. Moreno's relationship with Congressman Garcia—on a Navy issue unrelated to Wedtech.

[66] Hearing Record, Part 2 at 32.

[67] Hearing Record, Part 2 at 34.

At the time Captain Kelley took over as program manager of the pontoon contract in early 1986, Wedtech had completely exhausted a $30 million line of credit and was relying upon progress payments from the Department of Defense to remain afloat. As Mr. Moreno stated, "We would be at their doorstep every week for every penny we could squeeze out of them." In March and April 1986, Wedtech started negotiating for an additional $30 million line of credit.[68] Without this new line of credit, Wedtech felt that it would not be able to stay afloat for the rest of the year.

In mid-1985, DCAS became concerned by Wedtech's delinquency on virtually all of the company's defense contracts. Of thirteen government contracts, two were not yet due, two included acknowledged government delays, and Wedtech was delinquent on the remaining nine. DCAS attributed these delinquencies to Wedtech's "lack of control of in-house manufacturing effort and inability to select and manage suppliers and subcontractors." [69] Two of Wedtech's delinquent contracts were terminated by the government in early 1986.[70] As Wedtech continued to submit proposals for still more contracts, DCAS began to recommend against award on the basis of the company's prior performance. From April 26 to September 18, 1985, DCAS completed at least six pre-award surveys on Wedtech; each recommended against award.[71]

In early 1986, DCAS concerns were compounded when the agency learned that Wedtech was losing huge sums of money on its two largest contracts, the Army engine contract and the Navy pontoon contract.[72] As a result of these losses, Wedtech was experiencing severe cash flow problems, and the company's late payments to vendors were leading to increasing delays in the receipt of material.[73] The precarious nature of Wedtech's finances was driven home to DCAS in March 1986, when agency officials learned that the company had exhausted its existing $30 million credit line and was negotiating for another $30 million. For this reason, Colonel Hein strongly recommended that a pre-award survey be conducted before the 1986 pontoon options were awarded to Wedtech.[74]

By telegram dated April 21, 1986, NAVFAC agreed to the pre-award survey. In an April 23 memorandum to the Commander of NAVFAC, Captain Kelley stated that the financial pre-award

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[68] Mr. Moreno explained that Wedtech's banks were willing to advance substantial amounts of money because of the company's backlog of government contract orders, which were shown as accounts receivable on the company's books even before the work had been performed—"We were showing a hundred million dollars in receivables from the government. That was unreal, but the auditors could not catch up with it." In some instances, Mr. Moreno stated, Wedtech went so far as to show *potential* government contracts as accounts receivable. Nonetheless, the banks insisted that the FY 86 pontoon contract options actually be awarded to Wedtech before they would extend the additional $30 million line of credit that Wedtech needed.

[69] September 18, 1985 Pre-Award Monitor Summary; *see* Hearing Record, Part 2 at 29–30 (Testimony of Col. Hein).

[70] February 6, 1986 DCAS Talking Paper.

[71] Pre-Award Monitor Summaries dated April 26, 1985, May 3, 1985, May 9, 1985, June 14, 1985, June 14, 1985, September 18, 1985. In one case—on a $30 million contract to produce "contact maintenance vehicles"—DCAS was directed to re-survey the company. The second survey, like the first, come back negative. September 18, 1985 Pre-Award Monitor Summary. These findings were reaffirmed by General St. Arnaud, the DCAS New York Region Commander, in a November 6, 1985 letter to Wedtech's President. November 6, 1985 letter from General St. Arnaud to Mr. Guariglia.

[72] *See* April 30, 1986 DCAS memorandum on "Anticipated Loss Contracts", estimating Wedtech losses at $2.94 million for the engine contract and $5.93 million for the pontoon contract.

[73] February 6, 1986 DCAS Talking Paper.

[74] April 11, 1986 letter from Colonel Hein to Mr. Schroeder.

survey was scheduled to be completed "this week" and that NAVFAC "should have a contract signed next week." In an April 25 memorandum to the Commander, Captain Kelley stated that the pre-award survey "will be positive since they clearly have no basis for any other position." In the same memorandum, Captain Kelley stated that Colonel Hein's superior, General St. Arnaud, had called him "to apologize" for DCAS' recommendation that a pre-award survey be conducted.

On April 29, 1986, DCAS completed its pre-award survey. Based on financial information provided by Wedtech, the Pre-Award Monitor recommended against award.[75] As the DCAS report explained, Wedtech had "a tremendous cash flow problem" The company's balance sheets, which showed working capital of $60.2 million, were misleading since $76.8 million of unbilled costs—some of which might never be realized—were included as assets. Without the additional $30 million line of credit projected by Wedtech, DCAS found, Wedtech would not have sufficient funds to perform the contract. Wedtech's banks had postponed the line of credit and appeared to be taking a "wait and see" attitude, making it impossible for DCAS to come to a positive recommendation.[76]

On May 9, 1986, Wedtech submitted a new Cash Flow Projection to DCAS in an attempt to prove its financial solvency. A DCAS review of this Projection, however, disclosed substantial errors and misstatements. After correcting for these problems, DCAS found that Wedtech had a severe negative cash flow. Wedtech had completely exhausted its existing line of credit and had a $4.6 million negative cash balance, rather than the $6.2 million positive balance shown by the company's own projection. If the new line of credit did not come through, the company would have a negative cash balance of $11 million by the end of the year. The DCAS review concluded that Wedtech would not be able to perform the pontoon options without the new line of credit.[77]

At this point, Captain Kelley wrote a memorandum to the Commander of NAVFAC, in which he complained that DCAS' "no award" recommendation was "based on a pre-established position which is supported by selected use of financial information." Wedtech, Captain Kelley reported, had the financial capacity to perform the options with or without the new line of credit:

> WEDTECH currently has the financial capacity to accomplish the FY86 option without the increased line of credit which WEDTECH is pursuing to support growth beyond current programs. The linkage of the preaward recommendation to an increased line of credit has been demonstrated to be improper based on the fact that WEDTECH currently has over $5 million available on their current credit line . . .[78]

According to Colonel Hein, who oversaw the DCAS review, Captain Kelley told him "that he thought that [Wedtech] should have the contract, and their financial situation was none of my business." [79]

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[75] April 29, 1986 Pre-Award Monitor Summary.
[76] April 29, 1986 Financial Analyst's Report.
[77] May 12, 1986 memorandum from Mr. Wrubel to DCASR NY-GND.
[78] In an interview with the Subcommittee staff Captain Kelley insisted that he waited until Wedtech received its new line of credit before approving the exercise of the options. This statement is not supported by the documentary evidence.
[79] Hearing Record, Part 2 at 31.

Colonel Hein testified that Captain Kelley went to his superior, General Arnaud, and persuaded him to conduct a new pre-award survey.[80] As Captain Kelley's May 15 memorandum reports, DCAS agreed to provide the new survey results within four days—including a weekend—by Monday, May 19. Colonel Hein testified that this new survey was "taken out of [his] hands." Wedtech threatened to sue Colonel Hein over his role in the previous survey; as a result, he was instructed to "keep a lower profile" and to stay away from meetings at Wedtech.[81]

On May 16, 1986, Wedtech sent 123 pages of revised financial information to DCAS. According to Mr. Moreno, DCAS "felt that there was something really wrong with our financials." Wedtech officials denied allegations about their financial condition and pressured DCAS "to stop being so obstinate." At the same time, Mr. Moreno stated, Wedtech was well aware that DCAS' suspicions were true.

On May 20, just four days after the Wedtech submission, DCAS recommended award of the FY 86 pontoon options to Wedtech without regard to whether the company succeeded in getting a new line of credit.[82] The pre-award monitor's report accepted Wedtech's statement that it would have a positive cash balance of $2.3 million at the end of the year and was financially capable of performing the options. The report made no attempt to explain how the new financial information provided by Wedtech differed from the earlier, data supplied by the company, which the same official had found to be inaccurate.[83] On May 21, the day after it received the DCAS report, the Navy signed a contract modification awarding Wedtech the FY 86 option.

4. WEDTECH'S BANKRUPTCY

a. The Progress Payment Issue.—Progress payments are paid by government agencies to finance performance by government contractors; in this way, the government expects to avoid paying for private financing. Small businesses such as Wedtech are normally paid 95% of their costs as those costs are incurred, enabling them to continue performing without running out of money. These progress payments are made on a monthly basis, when requested by the contractor. The contractor must certify to the validity of each progress payment request.[84]

Where a company is losing money on a contract, however, it is not entitled to payment at the usual 95% progress payment rate. A projected loss on the contract means that the company is spending money to produce less than was planned in the contract. Thus, if the government paid progress payments at the usual rate, it would end up paying the company more than it had earned—half the contract price for less than half the work, for example. Where the

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[80] Hearing Record, Part 2 at 31–32.
[81] Hearing Record, Part 2 at 31–32.
[82] May 20, 1986 Pre-Award Monitor Summary.
[83] May 19, 1986 Financial Analyst's Report.
[84] 48 C.F.R. Part 32.5.

company's losses are significant—as Wedtech's were on the pontoon contract—payment at the usual rate could ultimately result in the company receiving all the payments authorized under the contract without coming close to finishing the work it was supposed to perform. For this reason, the Federal Acquisition Regulation provides a formula for reducing progress payments in cases where the contractor is losing money on the contract.[85]

In this case, DCAS was well aware that Wedtech was losing money on the pontoon contract. Wedtech's Administrative Contracting Officer, Marvin Liebman, told the Subcommittee staff that DCAS knew that Wedtech was "buying in" to the pontoon contract and would lose money. Mel Zitter, the Contract Administrator for the pontoon contract, confirmed this, stating that if Wedtech had completed production, it probably would have lost $15 to $20 million on the contract.

In the first five months of 1986, Wedtech requested almost $23 million in progress payments based on the maximum payment rate of 95% of incurred costs. DCAS actually paid Wedtech substantially less than requested, as follows:

[Dollars in millions]

Month	Amount requested	Amount paid
January	$6.3	$4.3
February	6.6	4.0
March	3.6	3.0
April	3.9	3.0
May	2.5	2.0
Total	22.9	16.3

Nonetheless, the $16 million paid to Wedtech by the Navy between January and May 1986 was the maximum amount of progress payments that could be paid for the life of the contract. If the loss formula in the Federal Acquisition had been applied, Wedtech would have received much smaller payments over a longer period of time,[86] extending until the delivery of the last pontoon under the FY 85 options.

In fact, Wedtech requested at a March 6, 1986 meeting with DCAS that the remaining progress payments be made in precisely the amounts ultimately paid by DCAS. According to a DCAS memorandum of the meeting:

> [T]he WEDTECH representatives admitted that the contract was in a loss position and requested that remaining progress payments, i.e., up to the 95% ceiling (90% for the last option) which approximate $8 million be amortized over a three (3) month period as follows:

[85] 48 C.F.R. Section 32.503-6(g).

[86] February 20, 1986 DCAS memorandum on "Anticipated Loss Contracts", Paragraph 2(h)(3) states "Eligible for Payment per loss ratio—0"; April 30, 1986 memorandum on the same subject makes the same statement.

[Dollars in millions]

Month:	*Amount*
March 1986	$3
April 1986	3
May 1986	[87] 2

By May 1986, all possible progress payments under the FY 85 options had been made to Wedtech. Wedtech's performance on the options, however, was still far from complete: Wedtech did not deliver the final unit under the FY 85 options until September 12, 1986.

At this point, the Navy appears to have hastened the exercise of the FY 86 pontoon to ensure that progress payments to Wedtech would continue. On March 7, 1986, Wedtech complained to the Navy that DCAS intended to "withhold all or a substantial part of [the company's latest progress payment request] because of the company's possible loss position on the contract." Wedtech requested prompt action on the FY 86 options to ease the company's cash flow situation and add an "extra cushion" to the contract.[88]

On April 16, 1986, NAVFAC sought clearance to proceed with a letter contract award of the options to Wedtech. As Admiral Cowden, the NAVFAC commander, noted in a memorandum to Mr. Pyatt the next day, Wedtech threatened to stop production if progress payments were not continued under the FY 86 option. On April 22, the Assistant Secretary's office approved Wedtech's proposal to award the FY 86 options immediately on the basis of a "not-to-exceed" price subject to a downward adjustment on the basis of audit and cost/price analyses.[89] Because of the initially negative pre-award survey, however, the contract modification awarding Wedtech the FY 86 option was not actually signed until May 21, 1986.

As soon as the Navy exercised the FY 86 option on the contract, making more funding available, DCAS stopped making deductions from Wedtech's progress payments. DCAS records indicate that Wedtech's progress payments were paid in full from June 1986 to September 1986 and only a minor reduction was made in October:

[Dollars in millions]

Month	Amount requested	Amount paid
June	$10.9	$10.9
July	4.0	4.0
August	5.6	5.6
September	3.0	3.0
October	7.4	6.9
Total	30.9	30.4

At the time Wedtech was receiving these massive progress payments, the company was making no discernible progress on the FY 86 option. In fact, Wedtech never produced a single pontoon under the FY 86 option, as the company's delivery schedule slipped two months over a period of just three months (while it was paid $20 million) during the summer.

[87] March 7, 1986 memorandum from Mr. Liebman to File.
[88] March 7, 1986 letter from Mr. Moreno to Mr. Schroder.
[89] Handwritten notes of Ms. Brubeck re: April 22, 1986 meeting.

b. The Reasons for Overpayments.—The Administrative Contracting Officer for Wedtech, Marvin Liebman, told the Subcommittee staff that he was aware that Wedtech was losing substantial amounts of money on the contract at the time he approved payments to the company in the second half of 1986. However, Mr. Liebman stated that the Navy was insistent that it receive its pontoons on time and reduced progress payments to Wedtech might have resulted in delayed shipments. Indeed, Mr. Liebman stated that reductions or withholding of progress payments to Wedtech might have "killed the contractor" because of Wedtech's precarious financial condition.[90] Under such circumstances, the Defense Logistics Agency authorizes contracting officers to refrain from applying the FAR formula to reduce contractor progress payments.[91]

The chief of the DCAS contract management division in New York, Samuel Stern, told the Subcommittee staff that he received a "tremendous amount of pressure" from his superiors—Colonel Hein and his assistant, Leonard Gottfleisch—to process Wedtech's progress payment requests as quickly as possible. Regardless of other work, Mr. Stern explained, Wedtech had to come first. According to Mr. Stern, "there was no other contractor in the New York DCASMA area that had a higher priority than Wedtech." "My direction was just to pull people off whatever they were working on and have them do Wedtech." Mr. Stern also stated that there was pressure to give Wedtech as much money as possible—"The contracting officer [Mr. Leibman] kept mentioning that they were in a loss position and he didn't know how to handle it because of the pressure he was under from above."

Mr. Stern's superiors, in turn, stated that they were under pressure from Wedtech and the Navy. Mr. Zitter stated that Bernard Ehrlich, a Wedtech lawyer and consultant, frequently contacted him to find out how soon DCAS planned to act on Wedtech's requests for progress payments. Colonel Hein told the Subcommittee that he, too, was pressured by Mr. Ehrlich, who would threaten to go over his head on the progress payment issue:

> Colonel HEIN. . . . Ehrlich would sort of say, 'Well, you know, you really need to handle this thing before the company does this and this and this," and he would mention the fact that maybe the company would go around to other means that they had to take care of it.
>
> Senator LEVIN. Were those means somebody in a higher position than you?
>
> Colonel HEIN. That was the indication, but he never made any specific names or places or anything.[92]

Colonel Hein also testified that the Navy adamantly resisted any effort by DCAS to withhold progress payments from Wedtech. He explained that Wedtech threatened to stop work if progress payments were withheld, and that the Navy "cringed" at this idea:

> Senator LEVIN. . . . Colonel, did you or your staff ever suggest the withholding of progress payments or other moneys from Wedtech because of their repeated production failures and schedule slippages?
>
> Colonel HEIN. Yes, sir, we did. At first there was quite a bit of resistance to it, because Wedtech had told the Navy contracting office, "If you withhold our progress payment[s], we are going to quit work." And as you know, the first ten causeways--I

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[90] The Navy's current Procuring Contracting Officer, Captain Wayne Goodermote, confirmed in an interview with the Subcommittee staff that Wedtech was losing money, but progress payments were not reduced because of the company's financial condition.

[91] DLA Manual, Section 32.590–4e.

[92] Hearing Record, Part 2 at 33. *See* Prepared Statement of Col. Hein at 2–3.

think that is the right number—were very critical to the Navy, and so they put a lot of pressure on the Navy. But we did from time to time withhold money.

Senator LEVIN. And what was the reaction from Wedtech to that threat?

Colonel HEIN. To withhold money?

Senator LEVIN. Yes.

Colonel HEIN. Well, they were upset about it, but they really did not think we could do it.

Senator LEVIN. Did not think you could do it?

Colonel HEIN. Yes, sir. They did not think we could do it.

Senator LEVIN. Why?

Colonel HEIN. They figured that they could go around us. It was quite a while down before they realized that we still had some authority to do things.

Senator LEVIN. "We" being at your level?

Colonel HEIN. DCASMA, yes, sir.

Senator LEVIN. Yes. And I believe you also told the Subcommittee staff that Navy officials cringed at the idea of withholding progress payments. Is that true?

Colonel HEIN. That is true because of the threat by Wedtech to stop producing those ten critical causeways they needed on those ships.[93]

As a result, Wedtech was paid $31.4 million on the FY 86 options (out of a $47.9 million contract amount) without producing a single unit, or even making discernable progress. When Wedtech declared bankruptcy in December 1986, the taxpayer was left "holding the bag" for these overpayments.

c. Default, Bankruptcy and Reprocurement.—On May 22, 1986, one day after the award of the FY 86 options, Wedtech obtained the additional $30 million line of credit it had been seeking. Within two and a half months, the company had borrowed $23 million against this amount,[94] and was back in financial trouble. In August 1986, Wedtech attempted to patch its finances together with a $75 million bond offering. Of this amount, $53 million went to retire the company's existing debt; the remaining $22 million was intended to serve as working capital.[95]

Despite the influx of more than $50 million in loans and bond proceeds over a four month period, Mr. Moreno told the Subcommittee staff, Wedtech remained on the ropes financially. According to Mr. Liebman, Wedtech began to submit inflated progress payment requests over the summer—a sure sign of financial trouble. Between August and October, the business fell apart: key middle management personnel started leaving the company, subcontractors reported increasing problems with non-payment and late payment for goods, and Wedtech's scheduled deliveries slipped two months over a period of just three months.[96]

As late as October 1986, Wedtech still hoped to patch its finances together with creative financing. Mr. Moreno told the Subcommittee staff that the company hoped to float a new loan and use the money for leveraged buy-outs of two larger companies. These mergers, Wedtech officials hoped, would have the effect of hiding the company's substantial losses in the larger profits of the other companies—"would bury all the garbage," as Mr. Moreno put it in his interview.

By this time, however, the United States Attorney's office in the Southern District of New York had started an investigation into programs payment fraud and other illegal conduct by Wedtech offi-

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[93] Hearing Record, Part 2 at 28.
[94] August 22, 1986 Prospectus for $75 million Wedtech bond offering at 6.
[95] August 22, 1986 Prospectus for $75 million Wedtech bond offering at 6.
[96] October 27, 1986 telex from NAVFAC to DCASMA New York.

cials. In early November, reports of Wedtech's allegedly illegal activities began to appear in the press, leading the banks and others to back away from deals they had been planning with the company. As Mr. Liebman explained, "nobody wanted to touch them." "Bad publicity killed some bank loans they were working out. With the killing of the loans, Wedtech was finished."

On December 5, 1986, Wedtech abruptly closed down its pontoon assembly line. The next day, the Navy terminated the company for default on the contract and on December 16, 1986, Wedtech declared bankruptcy. Ten months later, on September 10, 1987, the Navy re-awarded the pontoon contract to Paceco, Inc. of Gulfport, Mississippi. Under the new contract, the Navy agreed to pay Paceco $30 million—for work that Wedtech was already supposed to have completed.

As a result of Wedtech's bankruptcy, 1000–1200 employees lost their jobs in the South Bronx and an additional 240 jobs were lost at the Ontonagon shipyard, which had been owned and operated by Wedtech in northern Michigan.[97] The federal government lost approximately $30 million—$15 million in reprocurement and transition costs for the Navy, $12 million in progress payments by the Army for engines that were not delivered, and $3 million in investment by the SBA for equipment that has not been recovered.[98] Wedtech's stockholders lost some $100 million when the market for the company's stock collapsed; the company's subcontractors and creditors lost additional sums that cannot be estimated at this time.

5. DISCUSSION AND FINDINGS

a. The Piersall Report.—In August 1984 Wedtech was attempting to build the pontoons with makeshift facilities; the company was already behind in its performance and its schedule was slipping rapidly. Procurement officials responsible for administering the contract were highly concerned that Wedtech would not be able to deliver an acceptable product on time.

In September, however, a Navy report on the pontoon contract—conducted by Captain Piersall, a Navy officer from outside the program—found numerous deficiencies with the Navy's supervision of the program, but no significant problems with Wedtech's performance. Mr. Pyatt's Principal Deputy, Wayne Arny, testified that he requested this "independent study" because a dispute had arisen between the Navy and the SBA over Wedtech's performance. The report's primary conclusion, that Wedtech would be able to deliver the pontoons on time, was proven wrong within days—a strong indication that this conclusion was unreasonable at the time it was made. *The Subcommittee finds that the Piersall Report emphasized Wedtech's complaints and ignored substantial problems with Wedtech's production methods, quality and timeliness that had been observed by other Navy personnel. The report's failure to point out*

[97] Undated handwritten notes from SBA files (indicating up to 1209 Wedtech employees in the South Bronx in late 1984 and early 1985); August 5, 1986 letter from Wedtech to the SBA (indicating that Wedtech employed up to 242 additional employees at Ontonagon in 1985 and 1986 through U.P. Services Corp.).

[98] Data provided over the telephone to the Subcommittee staff by contracting officers for the Army and the Navy.

these difficulties may have prevented the Navy from fully recognizing the extent to which Wedtech was unable to perform.

The report's validity is further undermined by a confidential memorandum that Captain Piersall sent to Mr. Arny just two weeks after he submitted his report on the contract. This memorandum—which, unlike the Piersall report, was not circulated within the Navy—contradicted several of the key findings of the report, acknowledging that Captain Piersall was in no position to assess the validity of Wedtech's claims, that Wedtech's complaints might be a smokescreen for the company's own shortcomings, and that Wedtech would be unable to meet the Navy's schedule.

The memorandum from Captain Piersall to Mr. Arny raises substantial ethical questions. This memorandum was written in response to a request from Mr. Arny, who had received an advance copy of a Wedtech letter regarding an ongoing dispute with NAVFAC and requested Captain Piersall's advice as to whether the letter should be sent. Captain Piersall advised Mr. Arny that the letter was of questionable accuracy, but still advised that it be sent to "surface the problems." Mr. Arny testified that he passed this advice on to Wedtech consultant Mark Bragg and that the letter was sent.

The Subcommittee questions the propriety of the actions taken by Mr. Arny and Captain Piersall in advising Wedtech to send this letter. These officials were employed by the Navy to represent the interests of the United States, not to support the interests of private parties. While Captain Piersall may have recommended that Wedtech send this letter as a means of surfacing problems and leading to resolution, the Subcommittee does not believe that government officials should be providing this kind of advice to a contractor. As to Mr. Arny, Senator Cohen concluded that Mr. Arny did not fully appreciate the significance of his actions with regard to the pontoon contract:

> Senator COHEN. . . . Mr. Arny, I do not fault you under the circumstances, for seeking "outside advice" of a man who has had experience in the shipbuilding field, particulary with respect to SEASHED. I do think, however, that you were not in a position to make the kind of judgments that you were called upon to make, having just recently arrived on the job, and I think that some of these decisions were made, and you signed off on, without fully appreciating what the significance was.[99]

Accordingly, the subcommittee finds that the conduct of Mr. Arny and Captain Piersall in advising that Wedtech send the October 9, 1984 letter to NAVFAC creates the appearance that these officials were representing the interests of the contractor.

b. The Letter Contract Issue.—On November 19, 1984, Mr. Arny signed a memorandum directing NAVFAC to award the 1985 options to Wedtech by letter contract. If implemented, this memorandum would have resulted in the award of the options without price negotiations—a result later characterized by one Navy official as giving Wedtech a "license to steal." Moreover, by directing an award to Wedtech before Wedtech's first pontoons were even tested, the memorandum would have deprived the Navy of an important opportunity to assess Wedtech's performance prior to award.

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[99] Hearing Record, Part 2 at 132.

The Subcommittee finds that the Navy memorandum directing the exercise of the 1985 pontoon options without price negotiations would have served no legitimate government interest if implemented.

In his testimony before the Subcommittee, Mr. Arny stated that he signed the November 19 memorandum without understanding its implications. Mr. Arny testified that he did not know what a "letter contract" was at the time he signed the memorandum and that he assumed the price of the options would be subject to negotiations prior to award.

More than a dozen Navy officials who would ordinarily have participated in the drafting and review of the memorandum denied in interviews with the Subcommittee staff that they saw the document before it was written or that they knew the source of the memorandum. Former Wedtech Executive Vice President Mario Moreno has stated in a sworn affidavit to the Subcommittee that Wedtech had agreed to pay consultant Mark Bragg $200,000 if the 1985 options were awarded to Wedtech and $400,000 if the options were awarded without price negotiations. Mr. Arny strongly denied that Mr. Bragg had suggested to him that the options be exercised without price negotiations. He and other Navy officials stated that they were unaware of any pressure from outside the Navy on this issue.

The Subcommittee finds that the memorandum directing the exercise of the options without price negotiations was highly unusual and that the inability of any Navy official to explain the origin of the memorandum suggests that it may have originated from someone outside the Navy.

c. The 1985 Options.—Wedtech's first pontoons, delivered to the Navy two months later, failed their "first article test" in December 1984. These first pontoons were completely unacceptable—the corners were not even square, as they were required to be. More than eight months after the award of the contract, Wedtech was forced to start again from scratch, shutting down its assembly line to revise its production systems.

Nonetheless, the Navy continued to negotiate the 1985 pontoon options with Wedtech. On March 15, 1985, Wedtech was awarded more than $50 million to build eighty more pontoon units. At this time, Wedtech had missed every deadline established by the company or the Navy, and there was no certainty at all as to when Wedtech's first acceptable pontoon would be delivered.

NAVFAC documents indicate that the Navy exercised the 1985 pontoon options despite Wedtech's problems, because the lead time to bring in a new contractor would lead to further delays. In short, the Navy was committed to Wedtech, because it had ignored early warning signals on the company's performance and allowed the window for bringing in a second source to pass without action. As Senator Cohen explained at the Subcommittee hearing on September 29, the Navy simply had too much invested in Wedtech to go to a second source:

> Now we've got this firm involved. We've got start-up costs. We've got BDE funds involved. We've got all of this money invested. Performance is not too great, but as compared to what? Now we've got to make a . . . choice of whether we give them

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the option even though their performance is not up to standard . . . because the [alternative] is much worse.[100]

For these reasons, the Subcommittee finds that the Navy ignored early warning signals of Wedtech's inability to perform the pontoon contract and the advice of its frontline personnel, leaving itself with on choice but to award the 1985 pontoon options to Wedtech.

d. The 1986 Options.—Navy officials responsible for monitoring the pontoon contract complained about Wedtech's performance throughout 1985; Wedtech was delinquent on other contracts as well. As a result, DCAS repeatedly recommended against additional contract awards to the company and the Assistant Secretary's office finally agreed to bring in a second source for the pontoons, beginning with the FY 1986 options. The two-source plan was soon dropped, however, as a result of a temporary reduction in Navy requirements for the pontoons.

At the same time, Wedtech was experiencing severe financial problems. By early 1986, company officials believed that they needed to raise $30 million through a new stock offering to remain in business. The stock offering raised only $16 million, placing the company's ability to finance the 1986 options in grave doubt. DCAS officials recognized Wedtech's financial problems and conducted a pre-award survey, which found that Wedtech had misrepresented its financial condition and had a tremendous cash flow problem. The survey concluded by recommending against award of the 1986 options unless and until the company obtained additional financing.

Instead of following the DCAS recommendation, the new Navy program manager insisted upon a second pre-award survey, which recommended an award to Wedtech. A contract modification giving the options to Wedtech was signed the day after the second pre-award survey was submitted. Several circumstances suggest that the second survey was intended to reach a result more favorable to Wedtech, without regard to Wedtech's actual financial status:

(1) The program manager, Captain Tim Kelley, expressed skepticism about the need for any pre-award survey, stating in advance of the first survey that the results would "be positive since they clearly have no basis for any other position."

(2) Navy documents from Spring 1986 indicate that Captain Kelley and others were well aware that Wedtech had severe cash flow problems which were impeding the company's performance.

(3) When the first survey came back with a negative recommendation, Captain Kelley told the local DCAS commander, Colonel Hein, that Wedtech's financial condition was none of his business. Colonel Hein was told not to participate in the second pre-award survey, apparently at Captain Kelley's request.

(4) The second pre-award survey was conducted in a four-day period that included a weekend. Wedtech had submitted more than a hundred pages of new financial information for this survey; DCAS simply accepted Wedtech's conclusions without any attempt to reconcile the data to its earlier findings.

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[100] Hearing Record, Part 2 at 57.

(5) The second pre-award survey concluded that Wedtech had no cash flow problems and did not even need a new line of credit to complete the 1986 options. Former Wedtech officials have acknowledged to the Subcommittee staff that the financial information accepted by DCAS in the second pre-award survey was fabricated and that they had severe cash flow problems.

(6) Captain Kelley, the Navy Program manager who appears to have pushed for a positive pre-award survey, was helpful to Wedtech on other occasions, even to the point of providing favorable reports on Wedtech's performance to the Army in March 1986 and to a Wedtech underwriting firm in July 1986—at times when Wedtech was delinquent on the contract and suffered severe cash flow problems. Captain Kelley was appointed to succeed Captain de Vicq as program manager for the contract on an "emergency basis" when Captain de Vicq was unexpectedly transferred in early 1986; he was a personal friend of Wedtech consultants Jim Jenkins and Jim Aspin.

The first pre-award survey, and not the second, presented a more accurate picture of Wedtech's finances. Whether because the Navy was locked in to Wedtech as the only available source of pontoons or because Navy officials wished to assist a well-connected company, or both, the Navy appears to have been determined to reach a decision favorable to Wedtech. *Accordingly, the Subcommittee finds that the second pre-award survey documented a pre-determined conclusion and that the Navy awarded the 1986 pontoon options to Wedtech despite substantial evidence that the company was financially incapable of performing.*

e. The Progress Payment Issue.—In the five months following the exercise of the 1986 pontoon options, Wedtech did not produce a single one of the pontoons required by the options. Indeed, the company did not even produce the drawings which were necessary to begin production. Nevertheless, Wedtech requested $26.9 million in "progress payments" on the 1986 options and was paid $26.4 million. When Wedtech went bankrupt in December 1986, less than half of this money could be recovered from Wedtech's inventories.

DCAS officials have told the Subcommitte that they were aware that Wedtech was losing money on the contract and was not performing, but felt that they had no choice but to continue to make progress payments. As Administrative Contracting Officer Marvin Liebman explained, reduced progress payments might have further delayed Wedtech's shipments, or even forced the company out of business. Indeed, Navy documents indicate that the award of the 1986 options to Wedtech may have been accelerated to provide the company with funds to complete the 1985 options. One former DCAS official told the Subcommittee staff that all other work had to be put aside when a Wedtech progress payment request came in.

For these reasons, the Subcommittee finds that the Navy knowingly overpaid Wedtech despite substantial evidence that the company was financially incapable of performing the pontoon contract.

As Senator Levin concluded:

> For a time [, Wedtech's] influence peddling produced results as Federal officials reached a series of unwise and unfortunate decisions to grant more and more assistance to the company. In the end, however, those who could least afford it paid the price. While millions of dollars were bled from company funds to line the pockets of

company insiders and well-placed consultants, American taxpayers lost tens of millions of dollars, paid for products that Wedtech would never be able to deliver, and suffered a serious delay in the completion of an important element of our national defense. Small businesses and investors lost tens of millions of dollars when Wedtech failed to meet its obligations and went bankrupt. And perhaps most tragic of all, hundreds of low income employees from the South Bronx to northern Michigan lost the jobs and the hope that [the 8(a) program] had been intended to provide.[101]

[101] Hearing Record, Part 1 at 1-2.

IV. RECOMMENDATIONS

The Subcommittee's investigation of Wedtech has documented numerous instances of improper conduct by current and former federal officials and Wedtech owners and lobbyists. In some cases this conduct violated existing laws, regulations and agency procedures. Three United States Attorneys and an Independent Counsel are looking into possible criminal violations. In other cases, however, evidence suggests that the conduct, while not violating any specific statute or rule, may have been inconsistent with existing standards of ethical conduct and with the objectives of federal procurement programs and policies. In these instances, the Subcommittee has considered whether new or revised statutes or regulations are necessary to prevent a recurrence of those Wedtech abuses which evidence a generic problem. As a result, the Subcommittee recommends that numerous changes be made to the SBA 8(a) program and several changes be made to general procurement regulations and federal ethics laws.

A. The Section 8(a) Program

1. DISADVANTAGED OWNERSHIP

Section 8(a) of the Small Business Act should be amended to clarify that the required 51% ownership of a company or its stock by a socially and economically disadvantaged individual must be unconditional.

The SBA's conclusion that Wedtech's January 1984 stock transfer agreement was sufficient to transfer "ownership" of the company to John Mariotta was both incorrect as a matter of law and inconsistent with the objectives of the 8(a) program. As explained above, the price of the stock was never set, Mr. Mariotta did not put up any money for the stock, never received possession, and was unlikely ever to own it. Moreover, the SBA was aware that the sole purpose of the agreement was to reestablish "ownership" by disadvantaged individuals for 8(a) purpose.

The Subcommittee believes that, had the SBA conducted an objective review of this agreement, it would have concluded that it was not effective to transfer ownership for 8(a) purposes. However, no SBA rules, regulations, operating procedures or policy directives provide any standards by which the validity of such transactions should be judged. Indeed, the SBA does not even have a clear definition of what "ownership" means for the purposes of Section 8(a). This absence of guidance on an essential element of 8(a) eligibility enabled SBA officials to exceed the bounds of common sense and approve Wedtech's sham stock sale.

The 8(a) program confers a substantial benefit upon participants in the form of sole-source contracts, business development grants, interest-free loans, and management consulting services. The im-

portant public purpose of the 8(a) program is severely undermined, however, when individuals who are not socially or economically disadvantaged are permitted to participate. In a 1987 workshop organized by the National Academy of Public Administration, SBA officials responsible for administering the 8(a) program identified "front companies" as one of the most significant problems facing the program.[1] Such participation by non-disadvantaged individuals reduces the amount of contracts and other benefits available to those who are disadvantaged, diverts the energy and efforts of the SBA, and undermines support for the program.

For these reasons, it is vital that 8(a) participation be limited to companies that are truly owned by disadvantaged individuals. This means that "ownership" must be defined for 8(a) purposes, so as to exclude companies that are only nominally "owned" by socially and economically disadvantaged individuals. Ownership that is subject to conditions precedent, conditions subsequent, executory agreements, voting trusts, shareholder agreements, or other similar arrangements does not suffice to guarantee that the benefits of the 8(a) program will go to those for whom they were intended. Accordingly, the Subcommittee recommends that Section 8(a) of the Small Business Act be amended to clarify that the required 51% ownership of a company or its stock by a socially and economically disadvantaged individual must be unconditional.

The SBA in a recent revision of its regulations for the 8(a) program has attempted to close one possible loophole in the definition of ownership by treating stock options and convertible debentures as ownership for 8(a) purposes. This policy should have the effect of disqualifying companies whose *non-disadvantaged* owners could gain control by exercising stock options or convertible debentures. At the same time, however, the policy appears to open a new loophole, allowing *disadvantaged* owners to assert "ownership" of a company on the basis of *their* unexercised stock options or convertible debentures, a situation very similar to the Wedtech sham stock transaction. Indeed, while not named as such, the Wedtech stock arrangement was in fact little more than an option to buy on the part of Mr. Mariotta.

Thus, while attempting to close one loophole, the SBA has enlarged an already existing loophole. Even after the lessons of Wedtech and the issuance of new regulations, nothing in the SBA's rules would preclude agency officials from again assisting a favored company by approving a sham stock "sale" like Wedtech's.

2. ECONOMIC DISADVANTAGE

The SBA should be required to establish a threshold value of personal net worth that presumptively indicates a lack of economic disadvantage, but that provides a limited exception for personal assets invested in the 8(a) firm itself.

Section 8(a) should be amended to clarify that 8(a) contracts may be awarded only to firms that are economically disadvantaged at the time of the award.

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[1] National Academy of Public Administration, Management Review: Organization and Operation of the Minority Small Business and Capital Ownership Development Program (Nov. 1987) at II-3.

a. The Criteria for Economic Disadvantage.—The SBA permitted Wedtech to remain in the 8(a) program in 1984—and to receive the largest single contract in the history of the 8(a) program—despite the fact that the company had gone public, making its owners multi-millionaires. Over the next two years, Wedtech completed two more public stock offerings, tripled its line of credit, spun off several divisions, and absorbed two other companies. Its owners purchased fancy cars and condominiums, and are reported to have gambled extravagant sums in Atlantic City. Yet, Wedtech remained in the program and a staff recommendation that the company be terminated because its owners were no longer economically disadvantaged was never even acted upon by responsible officials in the New York district and regional SBA offices.

This result was possible, in part, because of the lack of specific SBA criteria for determining economic disadvantage. In 1984, the SBA required participants to provide it with information on their personal assets and net worth, but provided agency officials with no guidance as to how much net worth was too much to constitute economic disadvantage. The SBA's Standard Operating Procedures directed that other factors—such as access to capital and loans—also be considered, but did not explain how this information was to be evaluated.

The SBA has revised its economic disadvantage criteria in regulations and Standard Operating Procedures adopted in late 1986 and early 1987.[2] The new rules add some detail to the economic disadvantage definition that was in effect when decisions were made relative to Wedtech's eligibility. For example, new Standard Operating Procedures specify that an individual's economically disadvantaged status is to be considered in light of personal income for at least the past two years and the total value of all assets and holdings.[3] Similarly, business economic disadvantage is to be considered in light of business assets, net worth, income and profit, and numerous other factors.[4]

However, the economic disadvantage criteria remain completely subjective and open to the type of abuse and manipulation seen in the case of Wedtech. For example, the regulations state that any individual with a net worth of less than $750,000 (a questionable figure in itself) is presumed to be economically disadvantaged,[5] but no presumption is made that individuals worth more than $750,000 are not disadvantaged. On the contrary, the Standard Operating Procedures state that "Individuals with a net worth in excess of $750,000 may be considered economically disadvantaged in appropriate cases, but such applications should document clearly the disadvantaged status."[6]

Similarly, the new rules regarding business financial condition establish a host of complex (and undefined) factors to be considered, such as "current ratios", "quick ratios", inventory turnover, accounts receivable turnover, sales to working capital, returns on

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[2] 13 C.F.R. Part 124 (1987); Standard Operating Procedures effective April 27, 1987.
[3] 13 C.F.R. Section 124.106(b)(1) (1987).
[4] 13 C.F.R. Section 124.106(b)(2) (1987).
[5] The Subcommittee understands that the SBA is considering lowering this amount to $350,000.
[6] SBA Standard Operating Procedures, Paragraph 6(c)(1)(a)(ii) (1987).

assets, debt-to-net worth ratio, percentage return on investment, percentage gross profit margin, and percentage return on sales. However, these new rules provide no guidance on how these factors are to be calculated, weighted and evaluated. Thus, even if field office personnel could determine all of the relevant ratios, rates of return, and profit margins, they would have no way of knowing what to do with these numbers.

At the bottom line, the new Standard Operating Procedures leave the rules that were bent to permit Wedtech to remain in the program essentially unchanged. On personal economic disadvantage, the new procedures state that an individual's net worth is to be considered in light of the need "to capitalize or otherwise provide financial support to the business." [7] On business disadvantage, the new procedures state that 8(a) firms are to be evaluated by comparison "to other concerns in the same business area who are not socially disadvantaged." Moreover, even firms that compare favorably to other firms in the same business may prove economic disadvantage "in their narrative statements." [8]

This is precisely the formula that SBA officials and Wedtech representatives used to argue that Wedtech's owners remained disadvantaged despite the immense wealth brought by Wedtech's public stock offering. Wedtech claimed that its competitors were against corporations like General Dynamics and Lockheed, and the SBA uncritically accepted this argument. As for Mr. Mariotta's wealth, the company argued that the million dollars Mr. Mariotta held in liquid assets (not including his Wedtech stock) was necessary to support the business in its competition with the giants. With this precedent, any of thousands of companies that contract with the Defense Department could claim economic disadvantage, regardless of their size or the wealth of their owners. In fact, Mr. Mariotta's liquid assets represented money that he had taken out of the business, not money that he had put it. As a general rule, it should be possible to distinguish between money that has been put into an 8(a) firm—in the form of loans or stock purchases—and money that is held in personal bank accounts or investments for personal use.

To prevent future manipulation of economic disadvantage criteria, the Subcommittee recommends that the SBA establish a simple and enforceable standard of economic disadvantage. For several reasons, this standard should focus on the economic disadvantage of the individual owner(s), not of the company. First, the success of 8(a) companies is a primary objective of the program; it could be counterproductive to kick firms out of the program simply because they become profitable or acquire assets at a particular point in time. On the other hand, the success of a company need not mean immense personal wealth for its owners. Individual owners of 8(a) companies who pay themselves large salaries and sell off their stock (as Wedtech's owners did) are actually *disinvesting* in their companies and undermining their potential for success. Program participants should not be penalized for running successful businesses, but they should be penalized for taking funds from a successful business for their excessive personal consumption.

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[7] 13 C.F.R. Section 106(b)(1) (1987).
[8] SBA Standard Operating Procedures, Paragraph 6(c)(1)(b)(ii) (1987).

Section 8(a) already states that in determining an individual's economic disadvantage the SBA "shall consider, but not be limited to, the assets and net worth of such . . . individual." [9] However, the Subcommittee believes that the effect of this simple statutory directive has been blunted by the SBA's unguided consideration of the dozens of other factors set forth in the agency's new Standard Operating Procedures.

For these reasons, the Subcommittee recommends that Section 8(a) be amended to clarify that economic disadvantage is to be determined on the basis of the personal assets and net worth of an 8(a) firm's disadvantaged owner(s), and to require a threshold value of net worth that presumptively indicates a lack of economic disadvantage. There may be some narrow instances where specific circumstances justify continued participation by an individual who exceeds threshold levels, but these circumstances should be strictly defined by statute or regulation. For example, the Subcommittee recognizes the necessity of treating assets invested in an 8(a) firm differently from other assets. Owners of 8(a) companies should be encouraged to invest their own money in the 8(a) company, and an exception to the threshold level may be appropriate where the net worth of the disadvantaged owner is tied up in the 8(a) comapny. For these reasons, the Subcommittee recommends a limited exception to net worth limitations for assets invested in the 8(a) firm.

b. Economic Disadvantage After Program Entry.—Finally, SBA officials have told the Subcommittee that 8(a) participants are required to prove economic disadvantage only at the time they enter the program. As former Administrator James Sanders explained, the SBA allows companies to receive 8(a) contracts even after its owners have overcome their economic disadvantage:

> Mr. Sanders. . . . [I]f a company succeeds, having started in the 8(a) program, it will at one point in time no longer be economically disadvantaged. You simply do not throw it out of the program at that time.[10]

SBA General Counsel Robert Webber confirmed in his prepared testimony that current SBA policy is to evaluate economic disadvantage only when a company applies for admission into the 8(a) program, or when the company's ownership changes.[11]

The SBA's policy on this issue is inconsistent with Section 8(a) itself, which provides for the award of contracts to firms owned by individuals who *are* economically disadvantaged, not to those who were once economically disadvantaged.[12] This policy is inconsistent with one of the fundamental objectives of the program, which is to provide assistance to those who most need it. As explained above, the 8(a) program was not intended as a permanent support system for multi-milionaires who "cash-out" their 8(a) investment and pocket the money.

SBA officials argue that a rule requiring individuals to leave the 8(a) program when they are no longer economically disadvantaged would "penalize" these individuals for their success. The Subcom-

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[9] Small Business Act, Section 8(a)(6).

[10] Hearing Record, Part 1 at 128–29.

[11] Prepared Statement of Mr. Webber at 7 (Hearing Record, Part 1 at 222). This policy does not appear to be embodied in any SBA rules or regulations.

[12] 15 U.S.C. Section 637(a).

mittee disagrees: the denial of a benefit to those who are unqualified is not a "penalty." The success of an 8(a) company does not have to mean immense personal wealth for its owners. An individual who chooses to capitalize on the success of his or her company to become personally wealthy should not continue to reap the advantages of sole-source government contract awards, business development grants, and interest free loans. Statistics supplied to the Subcommittee staff by the SBA indicate that the vast majority of the 616 individuals admitted to the 8(a) program in Fiscal Year 1986 had a net worth of $200,000 or less. However, 14 individuals had a net worth of $500,000 or more, and two had net worths in excess of $800,000 at the time of program admission. The award of program benefits to companies that do not qualify for them can only result in less assistance being available to the companies that really need it.

Rather than focusing its efforts on successful companies owned by wealthy individuals, the SBA should be concentrating on bringing in new companies and assisting individuals who are still struggling to succeed. For these reasons, the Subcommittee recommends that Section 8(a) be amended to clarify that 8(a) contracts may be awarded only to firms that are economically disadvantaged at the time of the award. Companies owned by individuals who are no longer economically disadvantaged should not be permitted to retain their 8(a) status; to the extent that they still require assistance, such assistance could be provided through other applicable federal programs.

3. PROGRAM PARTICIPATION

Section 8(a) should be amended to strictly limit Fixed Program Participation term extensions.

Section 8(a) should be amended to require the SBA to schedule a hearing on any termination recommendation within three months of the initial notification of the company.

a. Fixed Program Participation Terms.—Just as SBA officials bent Section 8(a)'s eligibility requirements, they also bent program participation regulations to Wedtech's advantage. First, in 1983, the SBA issued a "bridge letter" granting Wedtech a temporary extension of its Fixed Program Participation Term (FPPT), despite the company's admission that it was no longer owned by disadvantaged individuals. Second, in 1984, Wedtech received a three-year FPPT extension despite the fact that Wedtech had already received huge amounts of 8(a) assistance and had used this assistance to make its owners multi-millionaires, rather than to develop an independent, self-sufficient business.

The first decision—to issue a "bridge letter"—may have violated an existing SBA policy against the issuance of program extensions to firms that no longer meet eligibility requirements. However, this SBA policy was not formally articulated in the agency's regulations or Standard Operating Procedures, and appears to have been ignored. The second decision—to grant the FPPT extension—is inconsistent with the evaluation criteria in the SBA's Standard Operating Procedures. However, SBA officials have told the Subcommittee that FPPT extensions were granted on a pro forma basis whenever

requested. Statistics gathered by the House Small Business Committee indicate that the length of FPPT extensions has varied from Region to Region in a manner apparently unrelated to business development objectives.[13] At least one high-ranking SBA official testified before the Subcommittee that he was not even aware of the agency's evaluation forms for FPPT extension requests.[14]

The routine grant of FPPT extensions to virtually any firm that requests such an extension, without objective evaluation, can only increase the expectation of participating firms that they will be permitted to remain on the 8(a) "life-support system" indefinitely. There may be legitimate reasons for limited FPPT extensions in some cases—for example, where an arbitrarily short initial term has not provided a company sufficient time to develop a balanced, competitive business base. However, the discretion involved in determining the length of an extension invites abuse. A company which, like Wedtech, has already enjoyed strong SBA support for years, is likely to have substantial clout when it comes time to grant FPPT extensions.

For these reasons, the Subcommittee recommends that Section 8(a) be amended to require that extensions to Fixed Program Participation Terms be strictly limited. This could be done by restricting the length of any 8(a) extension to no more than a year (instead of the 2-3 years routinely granted in the past) and requiring approval of any extension by the Administrator. In the alternative, Section 8(a) could be amended to guarantee every participant an identical FPPT of sufficient length at the outset, and to strictly prohibit *any* extensions.

b. Termination Procedures.—Wedtech also took advantage of the SBA's cumbersome termination procedures to remain in the 8(a) program long after it should have been found ineligible. These procedures have as many as eight levels of review permitted before an enforceable decision is reached: (1) a termination recommendation by the District Office staff; (2) approval of a notification letter by the District Director; (3) review of the company's response and recommendation by the District Director; (4) review by the Regional Office staff; (5) a termination recommendation by the Regional Administrator; (6) a termination recommendation by the central Office of Program Eligibility; (7) a hearing; and (8) a final decision by the Associate Administrator for Minority Small Business. The District Director is now required to reach a decision within thirty days of his notification letter, but none of the other reviews is limited in duration.[15]

The Deputy Administrator of the SBA's New York regional office, Aubrey Rogers, testified that a company intent on staying in the program can drag out this process almost indefinitely.[16] Moreover, the SBA itself has been lax in pursuing termination procedures. In Wedtech's case, a 1985 SBA staff recommendation that Wedtech be terminated because it was no longer economically disadvantaged was not acted upon for almost a year, and the company

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[13] House Small Business Committee, Report No. 100-460, 100th Cong., 1st Sess. at 25-26.
[14] Hearing Record, Part 1 at 85 (testimony of Mr. Rose).
[15] SBA Standard Operating Procedures at Paragraph 97 (1987); SBA Standard Operating Procedures at Paragraph 107 (1982).
[16] Hearing Record, Part 1 at 51-52.

ultimately agreed to voluntarily withdraw from the program before the SBA's District Director even made a formal recommendation (step three of the eight steps listed above). Not surprisingly, the SBA has been unable to identify a single instance in which a company was terminated from the program after a hearing.[17]

During the period that a termination recommendation is pending against an 8(a) firm, that firm remains eligible to receive 8(a) contracts and other assistance—even if it fails to meet any of the eligibility standards of the program.[18] SBA New York Deputy Regional Administrator Aubrey Rogers testified that the SBA would "probably not extend benefits" to such a firm,[19] but the agency's new Standard Operating Procedures limit any suspension of benefits to the period after the firm has been notified of a hearing (step 7 above).[20] Thus, an 8(a) firm can continue to receive sole-source contracts and other SBA assistance for months and perhaps years after it becomes ineligible.

The Subcommittee recognizes that 8(a) firms must be accorded reasonable procedural rights in any termination proceeding. However, the current system—with its eight levels of review and almost complete lack of time limits—lends itself to almost interminable delay. For these reasons, some of these multiple and redundant levels of review by SBA administrative officials prior to a hearing should be eliminated and others should be limited in duration. At a minimum, the Subcommittee recommends that the SBA be required to schedule a hearing on any termination recommendation within three months of the initial notification of the company.

4. COMPETITIVE CONTRACTING

Section 8(a) should be amended to require competition among 8(a) contractors for contracts over an established dollar value (including options for additional purchases).

Section 8(a) should be amended to permit the sole-source award of a contract below an established dollar value only with careful documentation of the qualification of the selected contractor, the reasons for the selection, and the basis for the rejection of other contractors (where other contractors were considered).

The SBA used highly questionable procedures to select Wedtech as its candidate for the pontoon contract. Several contractors which sought the contract prior to Wedtech have told the Subcommittee staff that they were led to believe that they would be given a substantial portion of the work, only to be told at the last minute that they would get nothing. Other contractors, which may have been more qualified than Wedtech, were not considered at all. The SBA made no attempt to document why Wedtech was considered qualified and other companies were not. In fact, Wedtech had never before performed a single assembly or metal-working contract of this type, had no facilities in place to perform the contract, could not meet the Navy's schedule, was already overdependent upon the

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[17] August 10, 1987 memorandum from the SBA's Acting Associate Administrator of the Office of Hearings and Appeals.

[18] Hearing Record, Part 1 at 51 (Testimony of Mr. Rogers).

[19] Hearing Record, Part 1 at 52.

[20] SBA Standard Operating Procedures, Paragraph 97(k) (1987).

8(a) program, and did not even meet 8(a) eligibility requirements at the time it was selected. These obvious problems with Wedtech's candidacy lend credence to the view expressed by company officials that they got the contract through the influence of their highly-paid consultants.

Despite all these problems, the SBA's selection process may not have violated any specific rules on contractor selection for the simple reason that the SBA has no objective or enforceable rules. Virtually all 8(a) contracts are awarded on a sole-source basis. The SBA's Standard Operating Procedures list a number of factors to be considered in the selection process—but do not provide any method for evaluating these factors.[21] Until recently, the Standard Operating Procedures did not even require any documentation of the process. In short, the SBA appears to have the power to select virtually any contractor it wishes for virtually any reason it chooses.

This system grants an immense power to SBA officials who select candidates for multi-million dollar contracts. With this power comes immense pressure from 8(a) companies, their consultants, and their allies in Congress and the Administration. The award to Wedtech is not the only instance of such abuse. In a recent survey conducted by the SBA's 8(a) office, 74% of the agency's District Directors agreed that the program is "overly influenced by political considerations." According to personnel in the 8(a) office, special treatment for companies with political contacts is a "way of life for 8(a) firms." [22] Perhaps as a result, one of the major problems with the 8(a) program since its inception has been that a few successful firms have monopolized a substantial share of the contract dollars and other assistance available. In 1986, the top 3% of 8(a) firms received approximately 55% of the contract dollars awarded in the program, while the top 10% of the firms received 80% of the contract dollars.[23]

The sole-source environment of the 8(a) program leads to heavy pressures on contracting agencies such as the Navy, as well. Assistant Secretary Pyatt testified that there are at least 5–10 cases every year when the Navy gets "severe heat"—including phone calls from members of Congress—to award 8(a) contracts.[24] Many participants in the 8(a) program—including not just Wedtech, but also its competitors—seem to believe that the road to contracts leads through well-connected consultants with friends in the Administration and the Congress. These consultants may use their contacts to bring pressure to bear not only on the SBA to select a specific contractor, but also on the contracting agency to set aside the contract and approve the SBA's choice of a contractor.

While some political involvement in these decisions is legitimate, as in the case of a member of Congress advocating the interests of constituents, the application of this kind of pressure to a program with few objective standards and officials with almost unlimited

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[21] SBA Standard Operating Procedures at Paragraph 45 (1987).

[22] National Academy of Public Administration, Management Review: Organization and Operation of the Minority Small Business and Capital Ownership Development Program (Nov. 1987) at II-9, II-3.

[23] House Small Business Committee, Report No. 100-460, 100th Cong., 1st Sess. at 28–29.

[24] Hearing Record, Part 2 at 135–36.

discretion may lead to unwise or inappropriate decisions. The solution is not to prohibit members of Congress or administration officials from making phone calls in appropriate cases, but to insulate the program by adding objective standards and limiting discretion.

For these reasons, the Subcommittee believes that competition should be utilized in the award of 8(a) contracts whenever possible. Competition among 8(a) contractors should have the effect of reducing the reliance of 8(a) companies upon consultants and friends in government to get contracts. It should reduce pressures on agency officials to set-aside contracts for the wrong reasons and on SBA officials to award contracts to the wrong companies. It should reduce disputes between the SBA and contracting agencies over fair market prices. In short, competition carries the promise of eliminating Wedtech-type influence-peddling from the 8(a) program.

The Subcommittee recognizes that some 8(a) contracts must continue to be awarded on a sole-source basis. The 8(a) program is a business development program, which includes numerous companies at different stages of development. An absolute requirement for competition among 8(a) companies with different resources and abilities might result in continued monopolization of the program by stronger, established companies, and prevent the growth of newer companies that the program is intended to foster. Moreover, there may be instances when a sole-source award is the only means by which the SBA can achieve a legitimate policy objective—for example, to target a specific, depressed area, or to target a specific type of contract for performance by 8(a) firms.

The Subcommittee believes that the need to safeguard the 8(a) program from Wedtech-type abuses can best be reconciled with the need to foster growth by newer and smaller 8(a) firms by restricting sole-source awards to smaller contracts. On the one hand, smaller contracts are the most appropriate for sole-source award to fledgling companies. On the other hand, these smaller contracts are likely to be a less tempting target for political influence and other abusive practices. It is unlikely that a company could afford to pay well-connected consultants millions of dollars in cash and stock—as Wedtech did—to get a $500,000 contract. Accordingly, the Subcommittee recommends that Section 8(a) be amended to require competition of contracts worth more than a specified dollar value, including options, in all but a few limited cases.

The Subcommittee is aware that there may be instances where competition within the 8(a) program for a contract above the specified dollar threshold is impossible, because only one 8(a) company is capable of performing the contract. In such cases, competition outside the 8(a) program—whether through the new competitive set-aside program established by the Department of Defense for small disadvantaged businesses, through the existing competitive set-aside program for small businesses generally, or even through free and open competition among all qualified bidders, may be preferable to a sole-source award within the 8(a) program. Indeed, the Subcommittee believes that 8(a) companies should be strongly encouraged to compete for contracts outside the 8(a) program in preparation for the completion of their program terms. Of course, there may be specific cases in which there are legitimate reasons for

keeping the award of a contract above the specified dollar threshold on a sole-source basis. To limit such sole-source awards to appropriate circumstances, the Subcommittee recommends that sole-source awards above the specified dollar threshold require prior approval at an appropriate high level of the SBA and documentation of the rationale for the decision not to compete.

Even in the case of contracts valued at less than the threshold amount, the Subcommittee believes that sole-source awards require considerable safeguards. Any time a contract is awarded on a sole-source basis, there is a potential for abuse in the selection of a contractor. Accordingly, the Subcommittee recommends that Section 8(a) be amended to prohibit the sole-source award of a contract of any dollar amount without documentation of the qualifications of the selected contractor, the reasons for the selection, and the basis for the rejection of other contractors (where other contractors were considered).

5. BUSINESS DEVELOPMENT

Participants in the 8(a) program should be required (after a reasonable amount of time in the program) to obtain a minimum percentage of their business from non-8(a) sources. Companies that fail to achieve the requisite percentage of non-8(a) business should not be awarded additional 8(a) contracts.

Limits should be placed on the size of any one 8(a) contract in relationship to past contracts and the total volume of a company's business.

Section 8(a) should be amended to limit the amount of Business Development Expense (BDE) grant money that may be awarded to any one company.

a. Business Mix.—The 8(a) program, as currently structured, provides every incentive for companies to pursue "plums"—sole-source contracts that are large enough to sustain a company for several years—rather than to build a solid, diversified business base. These plums appear to provide an easy road to success, promising instant growth without years of hard work. The result of this focus, however, is that the program tends to develop companies that are dependent on the program, rather than independent, competitive companies. At present, the SBA may not have the tools or the willpower to require participating companies to develop business outside the program, limit the size of 8(a) contracts, or otherwise prevent such unbalanced growth. As former SBA Administrator James Sanders explained to the Subcommittee, "the emphasis in the Section 8(a) program has been from the beginning on obtaining greater volumes of contracts without regard to development of management and technical skills without which no graduating firm can hope to succeed in the outside competitive world." [25]

Wedtech is a perfect example of a company which, despite its superficial success could not survive without the 8(a) program. In 1982, Wedtech was already a relatively successful 8(a) company, with only a moderate dependency on the 8(a) program. When Wedtech received the Army engine contract that year, however, it de-

[25] Hearing Record, Part 1 at 127.

voted so much effort to absorbing the contract that its competitive business base atrophied. In 1983, Wedtech made it owners multimilionaires by going public, yet it remained dependent upon the 8(a) program for 95% of its contracts. Rather than force the company to develop competitive business, SBA officials bent over backwards in 1983 and 1984 to keep the company in the program and award it the largest single 8(a) contract ever. Despite more than $200 million in 8(a) contracts awarded to the firm, Wedtech went bankrupt within eight months of its departure from the program in 1986.

A recent study by the General Accounting Office (GAO) demonstrates that Wedtech's dependence on the 8(a) program is typical of many long-term program participants. The GAO reviewed the business mix of 36 companies that had been in the 8(a) program for seven years or more, and found that eleven of these companies were dependent on the program for 90% or more of their business. Focusing on long-term participants which, like Wedtech, were successful in obtaining large 8(a) contracts, the GAO found an even more alarming picture: the ten companies that have been in the program for five years or more and received the largest 8(a) contracts in 1987 depended on the 8(a) program for an *average* of more than 80% of their contracts. Moreover, this average dependency rate had decreased by less than two percent over the course of these companies' tenure in the program.[26]

Part of this problem might be avoided by making 8(a) companies compete for contracts within the program, but as long as 8(a) contracts are easier to obtain than non-8(a) contracts, 8(a) firms will be tempted to pursue such contracts to the exclusion of other business. For this reason, the Subcommittee believes that enforceable guidelines should be established requiring balanced development by 8(a) firms. For example, (1) participants in the 8(a) program could be required, after a reasonable amount of time in the program, to obtain a minimum percentage of their business from non-8(a) sources; (2) companies that fail to meet requirements for developing non-8(a) business could be barred from receiving additional 8(a) contracts until they meet these requirements; and (3) limitations could be placed on the size of any one 8(a) contract in relationship to the total volume of a company's business.

The enforcement of such rules should ensure that companies that have been in the 8(a) program for a reasonable amount of time will become less reliant—rather than more reliant—on the program, and should enable the SBA to prepare 8(a) companies for departure from the 8(a) program without post-graduation bankruptcy and without huge "graduation gifts." At the same time, by limiting the amount of 8(a) contracts awarded to any one company, these rules should permit many more companies to benefit from the program.

b. Business Development Expense Grants.—In the fall of 1982, Wedtech was awarded a Business Development Expense (BDE) grant of $3 million to assist it in the performance in the Army

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[26] Statement of John H. Luke, Associate Director, Resources, Community, and Economic Development Division, GAO before the Senate Small Business Committee (Februray 18, 1988) at 5–7, App. I, J.

engine contract. At the same time, Wedtech was awarded $6 million of "advance payment" loans by the SBA—$2 million for the performance of the Army engine contract and $4 million for the performance of other contracts. In fiscal year 1982, when these awards were made, the SBA's total expenditures for BDS grants and advance payment loans amounted to only $5.8 million and $16.4 million, respectively. In short, Wedtech received more than half of the SBA's entire expenditures for BDE grants and more than a third of the agency's expeditures for advance payment loans in this period.

With regard to advance payments, SBA officials have told the Subcommittee staff that there are legitimate reasons why substantial payments are necessary on some contracts—for example, in oil or gas brokerage contracts, which may require large up-front investments. While the advance payment awards to Wedtech in the fall of 1982 may have been excessive in size, many larger advance payment commitments have been made in other years, and the Subcommittee does not have sufficient information to determine whether these other commitments were appropriate or inappropriate.

With regard to BDE funds, however, the 1982 grant to Wedtech was the single largest award ever made by the SBA. Former SBA Administrator James Sanders and Deputy Administrator Donald Templeman both stated at the Subcommittee hearing that they were concerned about the size of the grant and whether it was being put to good use. Indeed, Mr. Templeman wrote to the Army in early 1982 that "a multi-million dollar BDE grant to a single firm would . . . raise questions about our managment of the 8(a) program as a whole." Mr. Templeman pointed out that the average SBA's average BDE grant, given SBA's limited resources, was about $100,000. Most of the two or three thousand 8(a) firms have never received any BDE money at all.

While the grant to Wedtech may be the most dramatic case of a single company monopolizing a large amount of BDE funds, it does not appear to be the only case. Statistics provided by the SBA in response to pre-hearing questions from the Subcommittee indicate that twenty-two 8(a) firms have received more than a million dollars in BDE grants, for a total of more than $38 million in grants. This compares to a total of $56 million in BDE expenditures by the SBA over a five-year period from 1981 to 1985. In short, a handful of 8(a) firms appear to have monopolized a very high percentage of the SBA's total BDE expenditures over an extended period of time.

The Subcommittee believes that the award of a large percentage of available grant money to a single firm, or to a few firms, raises substantial questions about the SBA's management of its scarce resources. For this reason, the Subcommittee recommends that Section 8(a) be amended to limit the amount of BDE money that may be granted to any one company.

B. Lobbying and Government Ethics

1. LOBBYING ACTIVITIES

The Ethics in Government Act should be amended to require disclosure of Executive Branch lobbyists, similar to that currently required of Legislative Branch lobbyists.

The post-employment lobbying law should be amended to prohibit former, very senior Executive Branch officials from having contact with any Executive Branch agency for one year following federal employment.

The post-employment lobbying law should be amended to prohibit any person from communicating in the course of lobbying that such lobbying is on behalf of a former official if that former official is prohibited by law from engaging in such lobbying personally.

From 1982 to 1986 Wedtech hired numerous well-connected consultants to assist it in obtaining favored treatment from federal agencies. The efforts of these consultants to influence the White House, the Congress and the federal agencies, coupled with numerous well-documented program irregularities and Wedtech's success in its pursuit of millions of dollars of SBA assistance, the Army engine contract, the Navy pontoon contract, and a three-year extension in the 8(a) program creates—at a minimum—a serious appearance of impropriety.

Lobbying of federal agencies can serve many legitimate purposes, particularly in facilitating the flow of information and the exchange of views between the regulator and the regulated. Federal contractors and grant recipients, in particular, must be in regular contact with government officials at all levels, from contracting and grant officers and program managers to auditors and inspectors. The Subcommittee does not seek to interfere in the proper flow of information through these normal channels.

However, there are certain specific situations in which lobbying contacts create the appearance of improper activity and, in fact, may result in improper activity. This is the case, for instance, when, because of a prior or current personal or political relationship, a federal employee's decision may be—or may appear to be—made not on the content of what is being said or argued but on who is saying it. Current law has tried to carve out these situations and has imposed lobbying bans backed up with criminal sanctions.

18 United States Code 207—in relevant part—prohibits:

(a) Former Executive Branch employees from ever representing another person before any Executive Branch agency or federal court on a matter in which the former federal employee participated personally and substantially as a federal employee.

(b)(i) Former Executive Branch employees from representing another person before any Executive Branch agency or federal court on a matter in which was actually pending under the former federal employee's official responsibility for two years after leaving federal employment.

(b)(ii) Certain former high-level Executive Branch employees from aiding in the representation of another person through personal presence before any Executive branch agency or federal court on a matter in which the former high level employee participated

personally and substantially as a federal employee for two years after leaving federal employment.

(c) Former Executive Branch employees at the GS–17 and 0–9 and above levels (as well as certain other high-level officials designated by the Office of Government Ethics) from lobbying their former agencies for one year after they leave the Government.

Lyn Nofziger has, in fact, been convicted of violating this statute with regard to his efforts on behalf of Wedtech.

This statute, however, does not address a number of the problems raised by the Wedtech case. It pertains only to *former* Executive Branch employees, and even then, it does not include certain activity which the Wedtech case has demonstrated should be addressed.

a. Friends of current officials.—Former Wedtech consultant E. Robert Wallach requested assistance with various problems facing Wedtech in numerous memoranda sent to his friend, former counselor to the President Edwin Meese III. While such contacts are not improper in and of themselves, a friend of a current official may have every bit as much, if not more, influence with that official as a former colleague of that official. Current law does not recognize the appearance problem in such contacts, and places no particular restrictions or requirements on the lobbying activities of a current federal employee's friends.

The Subcommittee recognizes that it is virtually impossible to distinguish as a category those persons who may have unfair access to high-level federal officials because of their friendship or prior relationship with that federal official in a context other than federal employment. To impose any bans on such lobbying activity would be unduly burdensome, impossible to enforce and possibly counterproductive. Nonetheless the Subcommittee is troubled by the possible impropriety both in appearance and reality that can result from the undue influence friends can bring to bear on a current federal employee. Public awareness of the identification of lobbyists and the matters on which they are lobbying may help limit the abuses in this area. The role of Wedtech's consultants was unknown to the public, to Wedtech's competitors and frequently even to lower level officials who found their decisions inexplicably reversed at higher levels.

For these reasons, the Subcommittee concludes that lobbying of high-level Executive Branch officials should be brought out into the open. The Subcommittee recommends that the Ethics in Government Act be amended to require some form of disclosure of the activities of Executive Branch lobbyists. Congressional lobbyists have been required to disclose their activities since 1946 when the Registration of Lobbying Act was enacted; similar requirements might be appropriate for Executive Branch lobbyists. Under this approach, each Executive Branch lobbyist would be required to file periodic statements, available to the public, identifying each client on whose behalf the lobbyist is lobbying the Executive Branch, the specific matter on which he or she is lobbying, the period of employment for such lobbying and the amount received for such lobbying.

b. Other agencies.—A former senior official might have unfair access and influence not only at his or her own former agency but

also at other agencies. Wedtech consultant and former Presidential advisor Lyn Nofziger contacted not just his old agency, the White House, but the Army, Navy, SBA and Commerce Department officials on behalf of Wedtech. Such contacts by a close associate of the President, regardless of their actual impact, create the appearance of improper influence.

Current law does not recognize the contacts and potential influence that former high-ranking officials in one agency may have in another agency, or the appearance problems that lobbying by such officials may create. The one-year ban on lobbying your former agency applies only to your former agency; it does not apply to other agencies a former senior official might approach. Current law does contain a lifetime ban on lobbying any Executive Branch agency if the subject is a matter in which the former employee was personally and substantially involved.[27] But even the most senior officials—Cabinet officers and key White House staff—are not prohibited from lobbying agencies other than their own—even those with which they had frequent contact during their tenure with the government—on issues in which they were not personally and substantially involved.

For these reasons, the Subcommittee recommends that for the very top Executive Branch officials, particularly top White House officials, a one-year ban should apply for any contact with any Executive Branch agency, regardless of the involvement by the former top official in the subject matter. When a former top White House official lobbies former associates across the Administration on any matter, whether or not it was one in which he or she was personally involved, the appearance of and possibility for special consideration and treatment is strong. This recommendation has been incorporated in S. 237, the Integrity in Post Employment Act of 1988, which was sponsored by Senators Strom Thurmond, Howard Metzenbaum and Carl Levin, and was passed by the Senate on April 19, 1988.

c. Partners and Associates.—The lobbying of Messrs. Nofziger and Bragg on behalf of Wedtech raises a problem that has not been addressed in current conflict-of-interest law, namely the activities of partners and associates of former government employees. Current law bars certain former federal officials from lobbying their former agencies for one year after they leave the government. However, it does not establish any rule at all regarding the activities of a former official's partners or associates. Thus, under current law, Mr. Bragg was perfectly free to lobby the White House on Mr. Nofziger's behalf even though Mr. Nofziger was prohibited by law from contacting White House officials himself.

This is a significant gap in the coverage of current law. A partner or associate who lobbies an agency or employee whom the former official is barred by law from contacting may be able to influence a government decision, or could be perceived to influence a goverment decision, because of his affiliation with the former official. Where the partner or associate invokes the former official's name in an effort to influence government decisions, he or she is

[27] In fact, Mr. Nofziger was at first indicted for lobbying contacts he made with agencies other than the White House, based on this lifetime ban. This charge was dropped prior to trial.

doing indirectly what the law prohibits the former official from doing directly.

The Subcommittee recognizes that it would be unfair and inappropriate to preclude partners or associates of former government officials from representing before a federal agency their own clients or clients that are common to the former official and the partner or associate. At the same time, the Subcommittee is concerned that lobbying by partners or associates may be used as a way to end-run current law, as when a barred former official weights in on a government decision through a partner or associate.

For these reasons, the Subcommittee believes that current law should be changed to cover the activity of persons lobbying on behalf of former government officials. However, any change to existing law should focus only on the specific category of cases in which the partner makes it known during the course of his or her lobbying that such act is on behalf of the barred former government official. Accordingly, the Subcommittee recommends that the current post-employment statute be expanded to prohibit any person from communicating in the course of lobbying that such lobbying is on behalf of a former official if that former official is prohibited by law from engaging in such lobbying personally. This recommendation has also been incorporated in S. 237, the Integrity in Post Employment Act of 1988, which was sponsored by Senators Strom Thurmond, Howard Metzenbaum and Carl Levin, and was passed by the Senate on April 19, 1988.

2. WHITE HOUSE INVOLVEMENT IN PROCUREMENT DECISIONS

The current White House policy on contacts with procurement agencies (which prohibits staff members from contacting procurement officials on behalf of friends or relatives with a financial interest in a contract) is a sound policy which should be broadened to cover friends or relatives with any interest in a contract and should be continued by future Administrations.

White House involvement in specific federal procurements may be appropriate—provided that applicable procurement laws and regulations are observed—in a number of situations, including the implementation of a legitimate campaign promise such as President Reagan's promise to bring jobs and industry to the South Bronx. A White House staff member should not become involved in a procurement matter, however, in which the staff member or a friend or relative of the staff member has an interest. If that occurs, any legitimate rationale for the White House presence becomes tainted by the personal connection, and the public's faith in the procurement process is jeopardized. Moreover, because any involvement by the White House carries great weight and may effect the outcome of the procurement decisionmaking process, such involvement should occur only after careful analysis by key White House staff as to the appropriateness of the involvement. Even then, caution should be exercised in deciding the actual extent of any White House involvement.

The current White House policy on contacts by staff members with procurement officials essentially adopts this approach, establishing specific proscriptions on the conduct of White House staff

members in specific procurements. The Subcommittee believes that this policy properly balances the legitimate interest of the White House in participating in certain procurements with the need to avoid any appearance of improper influence. However, the current White House policy prohibits staff members from intervention in procurement matters only where the staff member has a friend or relative with a *financial* interest in the matter. The nature of a friend or relative's interest in a procurement matter may not always be clear to a White House staff member at the time intervention is required. Moreover, there may be an appearance of impropriety even where no direct financial interest is involved.

For these reasons, the Subcommittee believes that the current White House policy on contacts with procurement agencies should be broadened to prohibit staff members from contacting procurement officials on behalf of friends or relatives with *any* interest in a contract. With this caveat, the current policy is a sound policy and one that future Administrations should continue.

C. Other Contracting Issues

1. DOCUMENTATION OF DECISIONS

Contracting agencies like the Navy should institute procedures to ensure that the rationale for important contracting decisions is fully documented.

In January 1984, the Navy decided to set aside the pontoon contract for performance by an 8(a) contractor, despite concerns expressed by the officials responsible for administering the program. Three months later, in April, the Navy awarded the pontoon contract to Wedtech without a pre-award survey, despite considerable concern over problems with Wedtech and potential risks arising from the absence of a pre-award survey. In November 1984, top Navy officials directed that contract options be exercised by "letter contract" without an agreement on price (this directive was later withdrawn), despite considerable concerns about the quality and timeliness of Wedtech's performance. No attempt was made to document the reasons for any of these decisions.

Documentation of key contracting decisions provides an important safeguard against arbitrary or misguided choices by decision-makers. The articulation of a rationale for such decisions is an important exercise that can ensure that arguments on both sides are at least considered. Such documentation is particularly important when decisions on sole-source contracts are made at high levels of an agency as they were in the case of the Navy pontoon contract. Needless to say, such documentation can facilitate review of such decisions after the fact, whether by the agency itself or by Congress.

For these reasons, the Subcommittee recommends that contracting agencies like the Navy institute procedures to ensure that the rationale for any important contracting decision—such as a decision to set-aside a contract, to forego a pre-award survey, or to grant a letter contract—is adequately documented.

2. PROGRESS PAYMENTS

The Federal Acquisition Regulations should be revised to provide clear guidance on the circumstances in which a contractor may be paid at the maximum allowable rate during performance on a contract when such payment will leave insufficient funds to complete the contract.

Throughtout 1986, the Navy was aware that Wedtech was experiencing severe cost overruns on the pontoon contract. Under these circumstances, the Fedeal Acquisition Regulation requires a reduction of "progress payments" to a company to avoid overpaying the company or running out of money before the contract is completed. Nonetheless, the Navy continued to reimburse Wedtech at the maximum 95% rate. As a result, when Wedtech went bankrupt in December 1986, the Navy found that it lost some $15 million paid to the company for pontoons that had never been built.

Officials of the Defense Contract Administration Service (DCAS), which is responsible for determining the rate of progress payments on behalf of the contracting agency, have told the Subcommittee that they continued to pay Wedtech at the maximum rate, because the company needed the money to stay in business and continue delivering pontoons. In fact, a DCAS manual does authorize continued progress payments under such circumstances. However, the manual does not provide adequate guidance on how to determine whether continued payments are necessary to maintain deliveries. Nor does it require notification of high-level officials—or even formal documentation—before such payments are made.

The Subcommittee recognizes that there may be instances in which is it necessary to continue to pay a company at the maximum allowable progress payment rate even when such payments may exhaust all available funds before completion of the contract. For example, it may be necessary to continue maximum allowable payments to enable a company to stay in business and continue performing on an important national defense contract. However, unlimited discretion to continue such payments is an invitation to abuse. In the case of Wedtech, it appears that DCAS was subject to considerable pressure to pay the company as much money as possible as quickly as possible. The apparent justification for these payments was that the company was in a weakened financial state and desperately needed the money. However, DCAS never officially notified the Navy of this rationale, and the Navy continued to take the position that Wedtech was on sound financial footing.

For these reasons, the Subcommittee recommends that the Federal Acquisition Regulations be revised to define the circumstances in which a company may be paid at the maximum allowable rate despite cost overruns. The new regulations should require advance notification of the contracting agency of the decision that has been reached and documentation of the rationale for continuation of payments.

APPENDIXES

APPENDIX I: KEY INDIVIDUALS

GOVERNMENT OFFICIALS

WHITE HOUSE

Edwin Meese III, Counselor to the President (1981–1985).

James Jenkins, Deputy Counselor to the President (1981–1984), Wedtech Consultant, (1985–1986).

ARMY

John Marsh, Secretary of the Army (1981–Present)

J.R. Sculley, Assistant Secretary for Research, Development and Acquisition (1981–Present).

Delbert L. Spurlock, Jr., General Counsel (1981–1983).

Juanita Watts, Director, Small and Disadvantaged Business Utilization Office (1980–1987).

Dr. Thomas J. Keenan, Director of Procurement, Troop Support and Aviation Materiel Readiness Command (1973–1982).

NAVY

Everett Pyatt, Principal Deputy Assistant Secretary (1981–1984), Assistant Secretary for Shipbuilding and Logistics (1984–Present).

Wayne Arny, Principal Deputy Assistant Secretary (1984–1986).

Richard Ramirez, Director, Small and Disadvantaged Business Utilization Office (1981–1984).

Robert Saldivar, Director, Small and Disadvantaged Business Utilization Office (1984–1986), SBA Deputy Associate Administrator, Minority Small Business/Capital Ownership Development (1983–1984).

Admiral Thomas J. Hughes, Deputy Chief of Naval Operations for Logistics (1983–1987).

Captain David De Vicq, Program Manager, Pontoon Contract (1983–1985).

Captain Tim Kelley, Program Manager, Pontoon Contract (1986).

OTHER DEFENSE DEPARTMENT

Colonel Don Hein, Commanding Officer, Defense Contract Administration Service Management Area, New York (1984–1986).

SMALL BUSINESS ADMINISTRATION

Michael Cardenas, Administrator (1981).

James Sanders, Administrator (1982–1986).

Donald Templeman, Deputy Administrator (1981–1982).

Robert Luhlier, Administrator's Chief of Staff (1983–1984).

Bob Webber, General Counsel (1982–1988).

Henry Wilfong, Associate Administrator, Minority Small Business/Capital Ownership Development (1983–1984).

Robert Saldivar, Deputy Associate Administrator, Minority Small Business/Capital Ownership Development (1982–1984), Director of Navy Small and Disadvantaged Business Utilization Office (1984–1986).

Peter Neglia, Regional Administrator, New York (1981–1986), Administrator's Chief of Staff (1984–1986).

Edric Rose, Associate Regional Administrator, Minority Small Business/Capital Ownership Development, New York (1977–1988).

Aubrey Rogers, Deputy Associate Regional Administrator, New York, (1983–1984), Deputy Regional Administrator, New York (1984–Present)
David Elbaum, District Counsel, New York (1974–1986).

WEDTECH EMPLOYEES AND CONSULTANTS

COMPANY OFFICIALS

John Mariotta, Chief Executive Officer, Chairman of the Board.
Fred Neuberger, Chief Operating Officer, Director.
Mario Moreno, Executive Vice President, Director.
David Epstein, Aide to Mr. Mariotta.

CONSULTANTS

E. Robert Wallach, San Francisco Attorney.
Lyn Nofziger, Mark Bragg, Nofziger and Bragg Communications.
Stephen Denlinger, Latin American Manufacturers Association.
Arthur Siskind, Squadron, Ellenoff, Pleasent & Lehrer.
Bernard Ehrlich, Biaggi & Ehrlich.

APPENDIX II: ARMY ENGINE CONTRACT DOCUMENTS IN THE SUBCOMMITTEE'S PUBLIC FILES

I. Documents Obtained From Agency Files

A. 1980

Letter to Clifford L. Alexander, Jr., Secretary of the Army, from William A. Clement, Jr., Acting Associate Administrator for Minority Small Business, April 30, 1980.

Letter to Dr. Thomas Keenan, Director of Procurement, U.S. Army Troop Support and Aviation, Material Readiness Command, from Jose Aceves, President, Hartec Enterprises, Inc., May 28, 1980.

Letter to Paul R. Browne, Deputy Associate Administrator for Business Development, U.S. Small Business Administration (SBA), from Juanita P. Watts, Acting Director, Office of Small & Disadvantaged Business Utilization, June 6, 1980.

Letter to Clifford L. Alexander, Jr., from William A. Clement, Jr., August 28, 1980.

Memorandum to Commander, U.S. Army Materiel Development and Readiness Command, through the Assistant of the Army (RD&A), from Juanita P. Watts, September 2, 1980.

Memorandum to Ed Rose, ARA/MSB–COD, through Andrew P. Lynch, Acting District Director, from Gina A. Sanchez, ADD/MSB–COD, September 11, 1980.

Letter to Robert Quigley, SBA, New York Regional Office, from Thomas J. Keenan, Director of Procurement and Production, Department of the Army, October 3, 1980.

Planning Session for Pre-Proposal Conference Scheduled 11/3/80, October 30, 1980.

Memorandum for Record from J. H. Beckham, Contract Price Analyst, November 12, 1980.

B. 1981 (JANUARY–JULY)

Letter to U.S. Army Troop Support and Aviation, Material Readiness Command, from Jesse R. Quigley, Deputy Assistant Regional Administrator, Minority Small Business/COD, February 27, 1981.

Memorandum for Record from Harris E. Clark, Chief, Small Business Advisory, Industrial Assistance Office, March 10, 1981.

Memorandum to HQDA, OSA through Commander, U.S. Army Material Development and Readiness Command, March 17, 1981.

Point Paper, April 2, 1981.

Letter to Jesse R. Quigley from John Mariotta, President, Welbilt Electronic Die Corp., April 2, 1981.

Letter to U.S. Army Troop Support and Aviation, Material Readiness Command, from Jesse R. Quigley, April 2, 1981.

Letter to Michael Cardenas, Administrator, SBA, from Juanita P. Watts, April 10, 1981.

Letter to Jesse R. Quigley, from Anthony J. Andrews, Deputy Director of Procurement and Production, Department of the Army, April 13, 1981.

Letter to John R. Guthrie, Commander, U.S. Army Material Development and Readiness Command, from Manual Lujan, Jr., U.S. House of Representatives, April 13, 1981.

Letter to John Marsh, Jr., Secretary, Development of the Army, from John Mariotta, April 14, 1981.

Letter to Caspar Weinberger, Secretary, Department of Defense, from Karen N. Gerard, Deputy Mayor for Economic Policy and Development, City of New York, April 14, 1981.

Letter to John O. Marsh from Alfonse D'Amato, U.S. Senate, April 16, 1981.

Letter to Major General Edward Peter, Chief of Legislative Liaison, Department of the Army, from William L. Dickinson, U.S. House of Representatives, April 21, 1981.

Letter to U.S. Army Troop Support and Aviation, Material Readiness Command, from Jesse R. Quigley, May 1, 1981.

Letter to Jesse R. Quigley from Anthony J. Andrews, May 15, 1981.

U.S. Army Troop Support and Aviation, Material Readiness Command, from Jesse R. Quigley, June 8, 1981.

Letter to Paul Browne, Deputy Associate Administrator for Minority Small Business, SBA, from Juanita P. Watts, June 11, 1981.

Letter to Juanita P. Watts from Robert L. Wright, Jr., June 19, 1981.

Letter to William L. Dickinson, U.S. House of Representatives, from Johnnie H. Corns, Colonel, GS, Chief, Plans and Operations Division, Department of the Army.

Letter to John O. Marsh, Jr., from Senator Robert W. Kasten, Jr., June 26, 1981.

Letter to Timothy Sullivan, Capell, Howard, Knabe & Cobbs, P.A., from Michael A. Monts, Office of the Assistant General Counsel (Logistics), Department of Defense, July 2, 1981.

Letter to Robert L. Wright, Jr., from Juanita, P. Watts, July 14, 1981.

C. 1981 (AUGUST–DECEMBER)

Letter to John O. Marsh, Jr., from Dickey Dyer, Management Consultants, Princeton, New Jersey, August 12, 1981.

Memorandum for Record by O. Wayne Downhour, LTC, GS, Deputy for Disadvantaged Business Utilization, August 13, 1981.

Letter to John O. Marsh, Jr., from Jim Courter, U.S. House of Representatives, August 14, 1981.

Letter to John Marsh, Jr., from Christopher H. Smith, U.S. House of Representatives, August 17, 1981.

Letter to John O Marsh, Jr., from Joseph P. Addabbo, U.S. House of Representatives, August 25, 1981.

Point Paper: Status of Military Standard Engine Program, approved by Anthony J. Andrews, August 28, 1981.

Letter to John O. Marsh, Jr., from William L. Dickinson, U.S. House of Representatives, September 9, 1981.

Letter to R. R. Reusche, Assistant Inspector General for Investigations, from Steven Pineda, Acting Director, Office of Security and Investigations, SBA, September 2, 1981.

Memorandum to Ike Washington, Assistant Administrator for Business Development, from Jesse R. Quigley, September 2, 1981.

Letter to Juanita P. Watts, from Robert L. Wright, Jr., September 3, 1981.

Memorandum to John O. Marsh, Jr., from Wayne H. Valis, The White House, September 4, 1981.

Letter to Commander, Defense Contract Administration Services Management Area, from Anthony J. Andrews, September 8, 1981.

Audit Report on Evaluation of FFP Proposal DAAJO9–81–R–0022, submitted by Welbilt Electronic Die Corp., November 27, 1981.

Memorandum for the Deputy Assistant Secretary of the Army (Acquisition) from Donald W. Thompson, LTC, GS, Executive Officer, ODCA, December 4, 1981.

Memorandum for Director of Procurement and Production from Joseph A. Murray, Chief, Majority Commodity and Overhaul Division, December 22, 1981.

D. 1982 (JANUARY–JULY)

Memorandum from Jesse R. Quigley re Welbilt meeting, January 12, 1982.

Attendance sheet—Military Standard Engine contract; subject: Welbilt Electronic Die Corp.; location: SBA Central Office, January 15, 1981.

Letter to Michael Cardenas from Juanita P. Watts, January 16, 1982.

Letter to Robert Wright from John Mariotta, January 19, 1982.

Letter to Michael Cardenas from Senator Alfonse D'Amato, January 20, 1982.

Letter to John O. Marsh, Jr. from Senator Alfonse D'Amato, January 25, 1982.

Point Paper: Weekly Update Status of Military Standard Engines program, approved by W.G. Bowersox, LTC, GS, Deputy Director of Procurement and Production, January 26, 1982.

Letter to Delbert L. Spurlock, General Counsel, Department of the Army, from Stephen Denlinger, February 5, 1982.

Letter to Senator Alfonse D'Amato from John O. Marsh, Jr., February 18, 1982.

Memorandum for LTC Rutherford, OUSA, from William G. Yarborough, Jr., Colonel, GS, Executive, Department of the Army, February 25, 1982.

Letter to John O. Marsh, Jr., from Senator Robert W. Kasten, Jr., March 9, 1982.

Letter to Juanita P. Watts from Donald R. Templeman, March 19, 1982.

Memorandum for the Secretary of the Army from Delbert L. Spurlock, Jr., March 29, 1982.

Memorandum for Under Secretary of the Army from J.R. Sculley, Assistant Secretary of the Army (RD&A), March 31, 1982.

Memorandum for the General Counsel from Alex L. Parrish, Assistant to the General Counsel, Department of the Army, April 7, 1982.

SBA/Welbilt Electronic Die Corporation 8(a) Pilot Program Reservation, Military Standard Engines.

Letter to Stephen Denlinger from Delbert L. Spurlock, Jr., April 15, 1982.

Letter to Neil Kornblatt, Counsel, SBA, from Juanita P. Watts, April 16, 1982.

Letter to James C. Sanders from Juanita P. Watts, April 16, 1982.

Memorandum for Colonel James M. Miller, et al. from John W. Shannon, Deputy Under Secretary of the Army, April 20, 1982.

Point Paper: Weekly Update of Military Standard Engine Program, approved by W.G. Bowersox, May 10, 1982.

Memorandum for Colonel Romie L. Brownlee, Executive, OUSA, from William G. Yarborough, Jr., May 17, 1982.

Letter to J.R. Sculley, Assistant Secretary of the Army (RD&A), from John Mariotta, May 20, 1982.

Memorandum to USA TSARCOM, Jim Beckham, from Jesse R. Quigley, May 27, 1982.

Letter to James Jenkins from Lyn Nofzinger, undated.

Letter to James Sanders from Mark A. Bragg, June 3, 1982.

File memorandum by A. P. Murtagh re June 4, 1982 meeting.

Letter to James C. Sanders from J. R. Sculley, June 8, 1982.

Message to Commander for review; subject; Military Standard Engine Procurement Plan, June 12, 1982.

Letter to John Mariotta from James C. Sanders, June 18, 1982.

Letter to Peter Neglia, Regional Administrator, SBA, from John Mariotta, June 28, 1982.

Report on Welbilt's Proposal to Juanita Watts from O. Wayne Downhour, July 27, 1982.

E. 1982 (AUGUST–DECEMBER)

Message to Commander for review; subject: Military Standard Engine Solicitation, August 11, 1982.

Letter to Frank C. Carlucci, Deputy Secretary of Defense, from Senator Robert W. Kasten, Jr., August 24, 1982.

Information Memorandum for the Secretary of Defense from John O. Marsh, Jr., August 25, 1982.

Audit Report on Evaluation of FFP Proposal, No. DAAJ09–82–R–A600, submitted by Welbilt Electronic Die Corp., August 26, 1982.

Note from Thomas J. Keenan, Director of Procurement and Production, August 26, 1982.

Letter to Senator Robert W. Kasten, Jr., from Frank C. Carlucci, August 31, 1982.

Memorandum to TSARCOM, attention: DRSTS–PLH–B/R., Meyenburg, from Marvin Liebman, Contracting Officer, Defense Logistics Agency, September 2, 1982.

Letter to J. R. Sculley from Senator Robert W. Kasten, Jr., September 9, 1982.

Letter to Augustus C. Romain, Contract Negotiator, Office of Business Development, SBA, from John Mariotta, September 13, 1982.

Letter to Joseph A. Murray, DRSTS POB–B, Assistant Chief of Procurement, U.S. Army Troop Support and Aviation, Material Readiness Command, from Aubrey A. Rogers,

Acting Deputy Assistant Regional Administrator for Minority Small Business, SBA, September 13, 1982.

Memorandum for Dr. J. R. Sculley, et al., from George E. Dausman, Acting Deputy Assistant Secretary of the Army (Acquisition), Department of the Army, September 21, 1982.

Memorandum for the Director of the Army Staff from William G. Yarborough, Jr., September 21, 1982.

Welbilt Press Release for Contract Signing Ceremony.

Letter to Donald R. Keith, Commander, U.S. Army Materiel Development and Readiness Command, from J. R. Sculley, December 20, 1982.

II. Miscellaneous Documents Obtained by the Subcommittee

A. DOCUMENTS RE: WHITE HOUSE POLICY

Letter to Arthur B. Culvahouse, Jr., Counsel to the President, from Senator Carl Levin, November 19, 1987.

Letter to Senator Carl Levin from Arthur B. Culvahouse, Jr., December 7, 1987 (with enclosure of excerpt from White House Staff Manual discussing White House policy re: contacts between members of White House staff and procurement agencies).

Memorandum for White House staff from Peter J. Wallison, Counsel to the President, May 7, 1986.

B. KEY DOCUMENTS PRODUCED BY WHITE HOUSE

Action Memo to Lyn Nofziger, March 1981 [from Phillip Sanchez, Latin American Manufacturers' Association].

Letter to Edwin Meese III, Counselor to the President, from E. Robert Wallach, May 11, 1981.

Letter to Herbert Ellingwood, Deputy Counsel to the President, from E. Robert Wallach, May 11, 1981.

Letter to Edwin Meese III from E. Robert Wallach, May 13, 1981.

Letter to Edwin Thomas, Esq., Assistant Counsel, Office of the Counselor to the President, from E. Robert Wallach, May 19, 1981 (dictated by phone).

Message dictated from E. Robert Wallach for "ET" and "EM," May 19, 1981.

Memorandum to Edwin Meese III from E. Robert Wallach, June 18, 1981.

Letter to Mr. Kenneth Cribb, Deputy Director of Cabinet Administration, The White House, from Robert A. Turnbull, Associate Deputy Administrator, U.S. Small Business Administration (SBA), June 19, 1981, with letter to Juanita P. Watts, Director, Office of Small and Disadvantaged Business Utilization, Department of the Army, from Robert L. Wright, Associate Administrator for Small Business and Capital Ownership Development, SBA, attached.

Letter to E. Bob Wallach from David Epstein, Welbilt Electronic Die Corp., July 2, 1981.

Memorandum to Edwin Meese III from E. Robert Wallach, July 6, 1981 [sent to Ken Cribb July 9, 1981].

Memorandum to Edwin Meese III from E. Robert Wallach July 16, 1981.

Letter to Edwin Meese III from E. Robert Wallach, August 3, 1981.

Letter to E. Robert Wallach from David Epstein, Director, Special Projects, Welbilt Die Corp., August 8, 1981.

Welbilt Memorandum regarding Army Engine contract, August 8, 1981.

Letter to Edwin Meese III from E. Robert Wallach, August 31, 1981, with four memoranda attached.

Letter to Edwin Meese III from E. Robert Wallach, October 6, 1981.

Memorandum to Ed Meese from Bob Wallach, October 7, 1981.

Letter to Phillip Sanchez, from Lyn Nofziger, October 13, 1981.

Memorandum to Henry Zuniga from Stephen Denlinger, President, Latin American Manufacturers' Association (LAMA), October 20, 1981.

Letter to Michael Cardenas, Administrator, SBA, from Phillip V. Sanchez, October 29, 1981.

Letter to Franklyn Nofziger, Assistant to the President, from Phillip V. Sanchez, LAMA, November 9, 1981.

Letter to Edwin Meese III from E. Robert Wallach, December 30, 1981.

Letter to Edwin Meese III from Stephen W. Denlinger, January 6, 1982.

Letter to James A. Baker III, Chief of Staff and Assistant to the President, from Stephen W. Denlinger and Fernando E. C. De Baca, Chairman, LAMA, January 6, 1982.

Letter to Michael K. Deaver, Deputy Chief of Staff and Assistant to the President, from Stephen W. Denlinger and Fernando E.C. De Baca, January 6, 1982.

Letter to Franklin C. Nofziger from Stephen W. Denlinger and Fernando E.C. De Baca, January 6, 1982.

Letter to Elizabeth H. Dole from Stephen W. Denlinger and Fernando E.C. De Baca, January 6, 1982.

Letter to Franklyn Nofziger from Ambassador Phillip V. Sanchez, California Management Associates for the United States of America, January 8, 1982.

Letter to Edwin Meese III from E. Robert Wallach, January 19, 1982.
Letter to Edwin Meese III from E. Robert Wallach, January 21, 1982.
Background memorandum on Welbilt and Military Standard Engine [by Stephen W. Denlinger].
Letter to Fernando E.C. De Baca and Stephen W. Denlinger from Edwin Meese III, Febrauary 22, 1982.
Memorandum to Edwin Meese from Lyn Nofziger, Nofziger and Bragg Communications, April 8, 1982.
Letter to James Sanders, Administrator, SBA, from James E. Jenkins, Deputy Counselor to the President, April 22, 1982.
Handwritten note to "Jim" from S. Denlinger, with undated letter to James Jenkins from Lyn Nofziger, attached.
Handwritten note to "Jim" from Steve Denlinger, June 4, 1982, with June 3, 1982, letter to James Sanders from Mark A. Bragg, Nofziger and Bragg Communications, attached.
Letter to Senator Robert W. Kasten, Jr., from James E. Jenkins, July 27, 1982.
Letter to Elizabeth Dole from Stephen W. Denlinger, August 27, 1982.
Letter to "my friend Jim" from E. Robert Wallach, August 31, 1982 (with enclosure of news clip).
Letter to James Jenkins from E. Robert Wallach, September 8, 1982.
Handwritten note to Mark Bragg from "Jim" (undated).
U.S. Army Military Standard Engine Contract, with attached Financing Plan and handwritten note to "Henry" from "Steve," (undated).
To President Ronald W. Reagan from John Mariotta, President, Welbilt Electronic Die Corp., October 27, 1982.
Note to James Jenkins from James C. Sanders, November 5, 1982.
Memorandom for Jim Sanders from James E. Jenkins, November 8, 1982.

C. DOCUMENTS OBTAINED FROM THE FILES OF E. ROBERT WALLACH

Letter to Herbert Ellingwood from E. Robert Wallach, May 11, 1981.
Letter to Edwin Meese III from E. Robert Wallach, May 11, 1981.
Letter to Edwin Meese III from E. Robert Wallach, May 13, 1981.
Letter to Edwin Thomas, Esq., from E. Robert Wallach, May 19, 1981 (dictated over the phone to NYC).
Note to E. Robert Wallach from Herbert E. Ellingwood, May 29, 1981.
Letter to Herbert E. Ellingwood from David Upstein, June 11, 1981.
Memorandum to Edwin Meese III from E. Robert Wallach, June 18, 1981.
Memorandum to Edwin Meese III from E. Robert Wallach, July 6, 1981.
Memorandum to Edwin Meese III from E. Robert Wallach, July 16, 1981.
Memorandum to "Ed" from Bob Wallach, August 3, 1981.
Letter to Edwin Meese III from E. Robert Wallach, August 3, 1981.
Letter to Herbert Ellingwood from E. Robert Wallach, October 5, 1981.
Letter to Edwin Meese III from E. Robert Wallach, October 5, 1981.
Letter to Edwin Meese III from E. Robert Wallach, October 6, 1981.
Memorandum to Ed Meese from Bob Wallach, October 7, 1981.
Letter to Edwin Meese III from E. Robert Wallach, December 30, 1981.
Letter to Edwin Meese III from E. Robert Wallach, January 19, 1982.
Letter to Edwin Meese III from E. Robert Wallach, January 21, 1982.
Letter to Don Templeman, Acting Administrator, SBA, from E. Robert Wallach, February 18, 1982.
Letter to James E. Jenkins from E. Robert Wallach, September 8, 1982.
Letter to James E. Jenkins from E. Robert Wallach, September 10, 1982.
Memorandum to Edwin Meese III from E. Robert Wallach, April 2, 1983 (with attached Memorandum to Jim Jenkins).
Memorandum to James Jenkins from E. Robert Wallach, [May 23, 1983].

D. DOCUMENTS OBTAINED FROM THE FILES OF PIER TALENTI

Letter to Pier Talenti, Special Assistant to the President for Political Affairs, from Stephen Denlinger, July 28, 1981.
Letter to Michael Cardenas from Phillip V. Sanchez, August 24, 1981.
Memorandum to Pier F. Talenti from David Epstein, October 20, 1981.
Letter to Franklin C. Nofziger [sic] from Stephen W. Denlinger and Fernando E. C. De Baca, December 7, 1981.
Letter to Franklin C. Nofziger [sic] from Stephen W. Denlinger and Fernando E. C. De Baca, January 6, 1982.

E. EXCERPTS FROM NOTEBOOKS OF DAVID EPSTEIN

May 13; June 17; June 21; July 6; August 11; August 22; August 28; September 2; September 4; September 28, 1981.
February 1, April 6; April 26; May 6 to May 10; May 17 to May 19; June 1, 1982.

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